TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1935

No. 774

CORINNE S. KOSHLAND, PETITIONER,

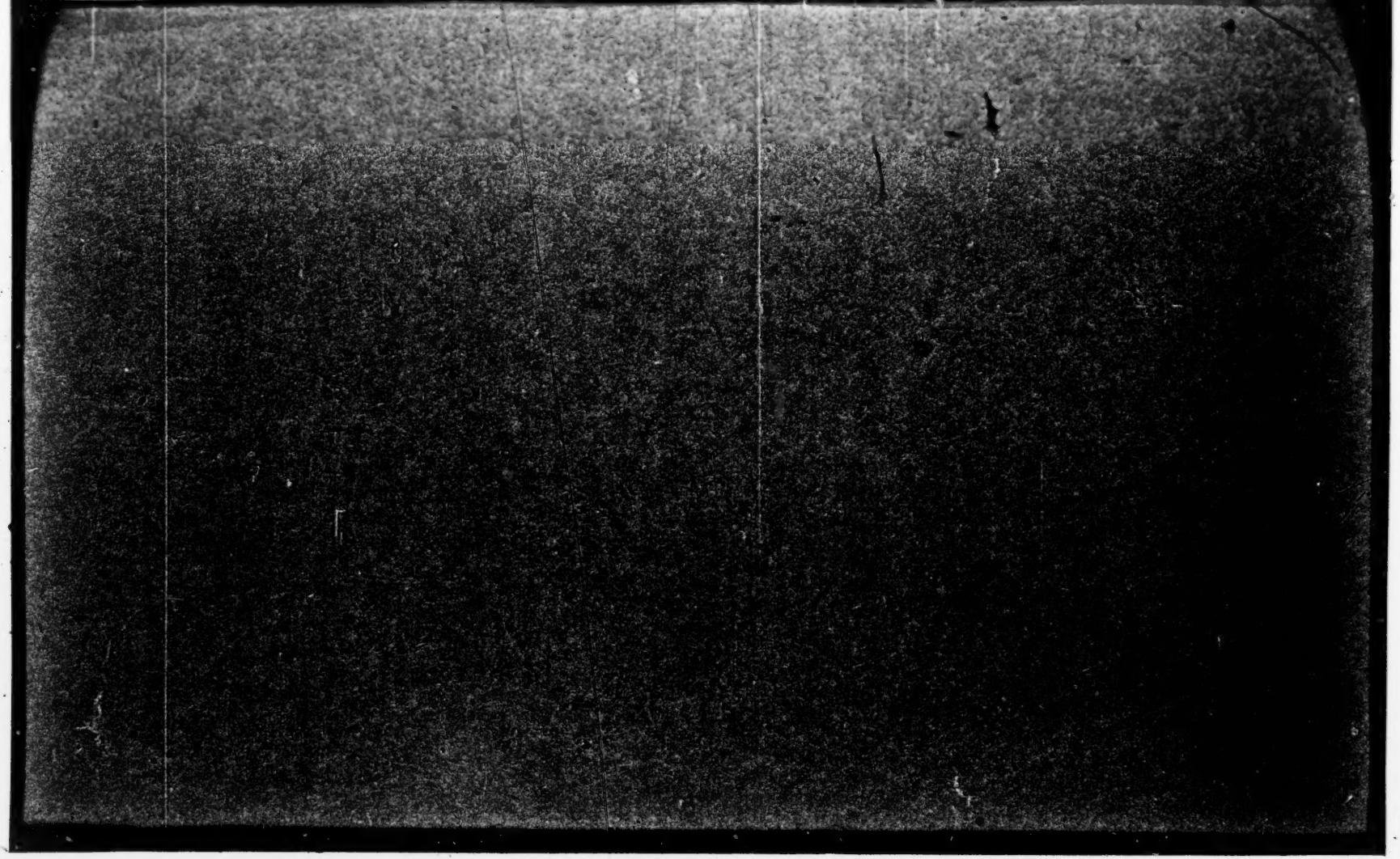
vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED FEBRUARY 25, 1936.

CERTIORARI GRANTED MARCH 30, 1936.



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APPEARANCES

For Taxpayer:
JOHN C. ALTMAN, Esq.

For Comm'r.:
H. D. THOMAS, Esq.,
E. M. WOOLF, Esq.

Docket No. 70917

CORINNE S. KOSHLAND,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1933

Apr. 5—Petition received and filed Taxpayer notified. (Fee paid)

" 5—Copy of petition served on General Counsel.

Jun. 2—Answer filed by General Counsel.

" 10—Copy of answer served on taxpayer. Circuit Calendar in the vicinity of San Francisco, California.

Jul. 17—Hearing set week of 9/11/33 at San Francisco, California.

Sep. 18—Hearing had before Mr. Leech. Submitted on the merits. Stipulation of facts read into the record. Briefs due Nov. 28, 1933. No exchange.

1933

Oct. 11—Transcript of hearing of 9/18/33 filed.

Nov. 27—Brief and proposed findings of fact filed by taxpayer.

" 27—Brief filed by General Counsel.

1934

Feb. 24—Supplemental brief filed by taxpayer.

Mar. 31—Memorandum opinion rendered, J. R. Leech, Div. 6. Judgment will be entered under Rule 50.

Apr. 16—Notice of settlement filed by taxpayer. 4/18/34 copy served.

" 17—Hearing set May 9, 1934.

" 26—Notice of settlement filed by General Counsel. copy served 4/28/34.

May 9—Hearing had before Mr. J. J. Marquette, Div. 1 on settlement under Rule 50—not contested—referred to Mr. Leech for decision.

" 14—Decision entered J. R. Leech, Div. 6.

Aug. 2—Petition for review by U. S. Circuit Court of Appeals (9) with assignments of error filed by General Counsel.

" 24—Proof of service filed by General Counsel.

Oct. 1—Motion for extension to Dec. 1, 1934 to complete and transmit record filed by General Counsel.

" 1—Order enlarging time to Dec. 1, 1934 to prepare evidence and deliver record entered.

Nov. 9—Motion re statement of evidence filed by General Counsel. Granted 11/15/34 and set for hearing 11/28/34.

1934

Nov. 9—Statement of evidence lodged.

" 9—Praecipe filed. Proof of service thereon.

" 26—Motion for extension to Feb. 1, 1935 to complete and transmit record filed by General Counsel.

" 26—Order enlarging time to Feb. 1, 1935 for preparation of evidence and delivery of record entered.

" 28—Hearing had before Mr. Leech on approval of statement of evidence. Continued to Nov. 30, 1934.

" 28—Order of continuance to Nov. 30, 1934 on approval of statement of evidence entered. [1*]

Nov. 30—Hearing had before Mr. Leech on approval of statement of evidence. C. A. V.

Dec. 1—Transcript of hearing of Nov. 30, 1934 filed.

" 4—Order that statement of evidence, submitted by Commissioner, be approved entered.

" 4—Statement of evidence approved and ordered filed. [2]

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*Page numbering appearing at the foot of page of original certified Transcript of Record.

United States Board of Tax Appeals

Docket No. 70917

CORINNE S. KOSHLAND,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION.

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:AR:E-2-MM R-60D) dated March 11, 1933, and as the basis of her proceedings, alleges as follows:

I.

The petitioner is an individual, with her address and residence at 3800 Washington Street, San Francisco, California. In the notice of deficiency hereinafter referred to, petitioner is erroneously designated as "Corrine S. Koshland".

II.

The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the taxpayer on March 11, 1933. The report of the Internal Revenue Agent in charge at San Francisco, California, dated September 15, 1932, was approved in said notice of deficiency and made a part thereof and accordingly, a copy of said report is attached and marked Exhibit "B".

III.

The taxes in controversy are income taxes for the [3] calendar year 1930 and for $833.48.

IV.

The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) Respondent erroneously determined that the exchange made by petitioner in 1929 to and with Transamerica Corporation, a Delaware corporation doing business in California, (hereinafter referred to as "Transamerica") of 32 shares of the capital stock of Bank of America, N. A., a national banking corporation (hereinafter referred to as "Bank") for 48 shares of the capital stock of Transamerica was a taxable transaction, when in truth and in fact this transaction was a non-taxable one, being an exchange made in connection with a reorganization as that term is defined in Section 112 of the Revenue Act of 1928. Accordingly, respondent erroneously fixed as the cost basis of said 48 shares of Transamerica the fair market value of said shares at the time of such exchange, instead of fixing as the cost basis of said shares of stock the cost basis of the 32 shares of stock of said bank.

(b) Respondent erroneously determined the cost basis and consequent profit to taxpayer in connection with the redemption during the year 1930 of 165 shares of preferred stock of Columbia Steel Corporation. In this behalf, petitioner alleges that respondent determined that the cost basis to petitioner of said 165 shares of preferred stock was the

sum of $11,505.80, whereas the correct cost basis of said shares of stock was and is $16,500.00. [4]

V.

The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) On April 18, 1928, petitioner purchased 20 shares of stock of Bank of America, N. A. at a price of $225.00 per share, or a total sum of $4500.00. In January, 1929, taxpayer, as the owner of certain shares of stock of Bank of Italy, received as a dividend thereon 12 shares of stock of Bank of America, N. A., and the market value of said 12 shares of stock of Bank of America, N. A., at date of receipt and therefore the cost basis of petitioner of said 12 shares of stock was $2316.00. The total cost to petitioner of said 32 shares of stock of Bank of America, N. A., was $6816.00. During the year 1929, taxpayer, in connection with a tax free reorganization as defined in the Revenue Act of 1928, exchanged said 32 shares of stock of Bank of America, N. A., for 48 shares of stock of Transamerica Corporation, and the proper cost basis to petitioner of said 48 shares of stock of Transamerica Corporation is the sum of $6816.00. During the year 1930 taxpayer sold said 48 shares of stock of Transamerica Corporation and in computing the gain or loss to petitioner with respect to said 48 shares of stock of Transamerica Corporation, respondent erroneously used as the cost basis thereof the sum of $6276.00, instead of the sum of $6816.00.

(b) On February 28, 1924, petitioner purchased 150 shares of preferred stock of Columbia Steel Corporation for the sum of $100.00 per share, or a total amount of $15,000.00. [5]

On March 2, 1926, petitioner purchased from said corporation 15 shares of its preferred stock for the sum of $100.00, per share, or a total amount of $1500.00.

That, pursuant to the Articles of Incorporation of said Columbia Steel Corporation during all of the times herein referred to, said shares of preferred stock were non-voting (the entire voting *rites* being vested in the shares of common stock) and had a par value of $100.00 per share and were redeemable at any time after five years from the date of incorporation at a price of $105.00 per share, plus all accumulated dividends. That Article IV of the Articles of Incorporation of said Columbia Steel Corporation at all of the times herein mentioned read as follows, insofar as appertained to the payment of dividends on said shares of preferred stock:

> "The holders of record of the shares of the preferred stock are entitled to receive dividends from and after the respective dates of issuance of such shares before any dividend shall be paid upon or set apart for the common stock as follows:
>
> At the rate of 7% per annum if the Board of Directors shall decide to pay such dividends in cash and at the rate of one share of common stock per annum on each share of preferred

stock if the Board of Directors shall have determined to pay such dividends in common stock of the corporation. Such preferred stock dividends shall be payable in semi-annual instalments on the 1st day of January and on the 1st day of July of each year. The dividends upon all of the preferred stock are cumulative, so that if any one year dividends shall not have been paid thereon, either at the rate of 7% per annum in cash or one share of common stock per annum on each share of preferred stock, the deficiency shall be paid either in cash or in stock, as aforesaid, before any dividends shall be paid upon or set apart for the common stock, and in the event of any liquidation or dissolution or winding up of the corporation, the holders of record of all the shares of the preferred stock shall be entitled, before any distribution shall be made to the holders of the common stock irrespective of the amount available to the holders of the common stock, to be paid in full the par value of [6] such shares of preferred stock, and also an amount found by deducting, from a sum equal to 7% per annum on the par value of the preferred stock from the respective dates of issuance to the date of distribution, the aggregate of the dividends which shall have been paid in cash or in common stock, computing said common stock for this purpose at $7.00 per share; and, after the payment of the amounts hereinabove specified to the holders

of record of the shares of the preferred stock they shall not be entiltled to any share or portion of the assets of the corporation. No dividends accruing after five years from the date of incorporation of this corporation on the preferred stock shall be paid in common stock."

Pursuant to the provisions of said Article IV, said corporation declared and paid in January, 1925, to the holders of record of the prefered stock of said corporation on December 31, 1924, a dividend at the rate of one share of common stock per annum on each share of preferred stock issued and outstanding during the year 1924, and declared and paid in January, 1926, to the holders of record of the preferred stock of said corporation on December 31, 1925, a dividend at the rate of one share of common stock per annum on each share of preferred stock issued and outstanding during the year 1925, and declared and paid in January, 1927, to the holders of record of the preferred stock of said corporation on December 31, 1926, a dividend at the rate of one share of common stock per annum on each share of preferred stock issued and outstanding during the year 1926, and declared and paid in July, 1927, to the holders of record of the preferred stock of said corporation on June 30, 1927, a dividend at the rate of half of a share of common stock on each share of preferred stock issued and outstanding during the half year period ending June 30, 1927.

Petitioner, as the owner of 150 shares of pre- [7] ferred stock of Columbia Steel Corporation, received

in January, 1925, 127 shares of common stock of said Columbia Steel Corporation, in payment of said cumulative annual dividend on shares of preferred stock for the year 1924, and the market value of each share of such common stock at date of such receipt was $6.50, and the cost basis to petitioner of each share of common stock received as aforesaid was not less than $6.50. Petitioner, as the owner of 150 shares of preferred stock of Columbia Steel Corporation, received in January, 1926, 150 shares of common stock of said Columbia Steel Corporation, in payment of said cumulative annual dividend on shares of preferred stock for the year 1925, and the market value of each share of such common stock at date of such receipt was $6.25, and the cost basis to petitioner of each share of common stock received as aforesaid was not less than $6.25. Petitioner, as the owner of 165 shares of preferred stock of Columbia Steel Corporation, received in January, 1927, 165 shares of common stock of said Columbia Steel Corporation, in payment of said cumulative annual dividend on shares of preferred stock for the year 1926, and the market value of each share of such common stock at the date of such receipt was $7.00, and the cost basis to petitioner of each share of common stock received as aforesaid was not less than $7.00. Petitioner, as the owner of 165 shares of preferred stock of Columbia Steel Corporation, received in July, 1927, 82½ shares of common stock of said Columbia Steel Corporation, in payment of said cumulative semi-annual dividend on shares of

preferred stock for the first half of the year 1927, and the market value [8] of each share of such common stock at date of such receipt was $7.00, and the cost basis to petitioner of each share of common stock received as aforesaid was not less than $7.00. In this behalf, petitioner sets forth that none of said shares of common stock received as aforesaid constituted a stock dividend. In this behalf, petitioner further sets forth that the exercise of the election on the part of said Columbia Steel Corporation to pay said cumulative preferred dividend in the form of common stock constituted an agreement between petitioner and said corporation whereby petitioner received $7.00 in cash as such cumulative annual dividend on each share of preferred stock held by her and used said $7.00 in cash for the contemporaneous purchase of one share of common stock from said corporation. This is confirmed by the recordance on the books of the Columbia Steel Corporation of a distribution of surplus to the preferred stockholders equivalent to $7.00 per share per annum and the corresponding increase of common stock outstanding.

Petitioner sets forth that the cost basis of the 165 shares of preferred stock of Columbia Steel Corporation acquired by her, as aforesaid is the sum of $16,500.00, and that such cost basis should not be reduced by the sum of $693.02 (representing the cost basis erroneously allocated to 127 shares of common stock received as a dividend in 1925), nor should said cost basis be reduced in the sum of

$1,108.62 (representing the cost basis erroneously allocated to 150 shares of common stock received as a dividend in 1926), nor should said cost basis be reduced in the sum of $1,129.71 (representing the cost basis erroneously allocated to 165 shares of common stock received [9] as a dividend in January, 1927); nor should said cost basis be reduced in the sum of $558.96 (representing the cost basis erroneously allocated to 82½ shares of common stock received as a dividend in July, 1927). In January, 1930, said 165 shares of preferred stock of Columbia Steel Corporation were redeemed for the sum of $17,325.00, and by reason thereof, petitioner realized a profit of $825.00, and no more.

VI.

During the year 1931, petitioner paid to the Collector of Internal Revenue at San Francisco, California, the sum of $1388.06, as and for income taxes for the calendar year 1930.

WHEREFORE, petitioner prays that this Board may hear the proceeding and determine that there is no deficiency in income taxes herein, and for such other relief as may be meet and proper in the premises.

JOHN C. ALTMAN
B. H. HICKLIN, C.P.A.
Counsel for Petitioner.
615 Russ Building,
San Francisco, Calif. [10]

State of California,
City and County of San Francisco.—ss.

CORINNE S. KOSHLAND, being duly sworn, says: That she is the petitioner named in the foregoing petition and is familiar with the statements therein contained and that the facts therein stated are true.

CORINNE S. KOSHLAND

Subscribed and sworn to before me this 31st day of March, 1933.

[Seal] LOUIS WIENER
Notary Public in and for the City and County of San Francisco, State of California. [11]

EXHIBIT "A"

NP-2-28

TREASURY DEPARTMENT
Washington

Mar 11, 1933

Office of
Commissioner of Internal Revenue
Address Reply to
Commissioner of Internal Revenue
And Refer to
Mrs. Corrine S. Koshland,
3800 Washington Street,
San Francisco, California.

Madam:

You are advised that the determination of your tax liability for the year 1930 discloses a deficiency of $833.48, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the inclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this form will expedite the closing of your return by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the inclosed form, or on the date assessment is made, whichever is earlier; WHEREAS IF THIS FORM IS NOT FILED, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNET,

Commissioner

By W. T. SHERWOOD,

Acting Deputy Commissioner

Inclosures:

Statement

Form 870 [12]

STATEMENT

IT:AR:E-2
MMR-60D

In re: Mrs. Corrine S. Koshland
3800 Washington Street,
San Francisco, California

Income Tax Liability

Year—1930
Income Tax Liability—$2,221.54
Income Tax Assessed—$1,388.06
Deficiency—$833.48

The report of the internal revenue agent in charge at San Francisco, California, a copy of which was furnished you, is approved and is hereby made a part of this letter.

Careful consideration has been accorded your protest dated November 1, 1932, in connection with the findings of the examining officer, and the information submitted at a conference held in the office of the internal revenue agent in charge. [13]

EXHIBIT "B"

TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE

San Francisco, Calif.

In re: Income Tax
Date of report: Sep. 15, 1932

Corinne S. Koshland,
3800 Washington St.,
San Francisco, Calif.

Years—1930
Additional Tax—$833.48
Overassessment—
Penalties—
Total—

The recommendations which this office proposes to make with respect to your income tax liability as the result of a recent examination by an internal revenue agent are shown in the statement attached.

If you acquiesce in the proposed tax liability the inclosed Form 870 should be executed and forwarded to this office. Your consent on Form 870 to the prompt assessment of any deficiency indicated will stop the running of interest to be assessed on such deficiency under the provisions of section 283(d) of the Revenue Act of 1926 or section 292 of the Revenue Act of 1928, upon a date not later than thirty days after the filing of Form 870 properly executed. Unless such consent is filed the interest to be assessed under the law upon any deficiency indicated runs to the date the deficiency is

assessed and the assessment may be made only as provided by Section 274(a) of the Revenue Act of 1926 and/or section 272(a) of the Revenue Act of 1928.

Should you desire to make immediate payment without awaiting formal assessment and notice and demand, you should communicate with the collector of internal revenue at Custom House, San Francisco, inclosing this letter, or a copy thereof. If payment is so made the interest period will terminate on the date of payment.

If you do not acquiesce in the proposed recommendations you should file a protest in writing with this office within 20 days from the date of this letter. Any protest so filed will be given careful consideration, and, if you so desire, you will be given an opportunity for a hearing before the recommendations are forwarded to Washington.

Arrangements will be made by this office upon your request to answer any questions which may occur to you in your review of these recommendations.

In any event please sign the inclosed form acknowledging receipt of this letter and related papers and return such form to this office.

Respectfully,

B. W. WILDE, JR.,

Internal Revenue Agent in Charge.

Inclosures:

Statement of adjustments

Form 870

Form of acknowledgment. [14]

Name Corinne S. Koshland

STATEMENT OF TOTAL TAX LIABILITY

Year—1930

Tax Previously Assessed—$1,388.06

Adjustments proposed in Accompanying Report

Deficiency—$833.48

Overassessment—None

Correct Tax Liability—$2,221.54

Totals— [15]

Preliminary Statement

Taxpayer: Corinne S. Koshland

Examining Officer: M. Surryhne

Table of Contents

Schedule 1, Block Adjustments

2, Computation of Tax

Exhibit A, Cost of Transamerica

B, do of Columbia Steel

Principal cause of additional tax: Adjustment of cost of Transamerica and of Columbia Steel.

All changes were discussed with Mr. Redman, who does not concede the method of adjusting cost of Columbia Steel.

Taxpayer: Single, with no dependents.

Related cases: None [16]

Corinne S. Koshland

Schedule 1
Block Adjustments

	Return	Additions	Deductions	Corrected
3. Interest	3,517.00	a. 219.44		3,736.44
4. " 2% paid	3,924.44		a. 219.44	3,705.00
7. Rents	28,110.79			28,110.79
8. Profit from Sales	(30,137.93)	b. 9,174.26		(20,963.67)
9. Lib. Bd. Int.	297.50			297.50
10. Dividends	59,641.46			59,641.46
11. Other Income	365.93			365.93
12. Total Income	$65,719.19			$74,893.45
13. Interest	16,989.42			16,989.42
14. Taxes	4,384.87			4,384.87
17. Contributions	6,470.39		c. 1,376.13	7,846.52
18. Other deductions	1,209.00			1,209.00
19. Total do	$29,053.68			$30,429.81
Total Income	$36,665.51	(9,393.20)	(1,595.57)	44,463.64

Schedule 1-a
Explanation of Items

a. Included on Line 4 is interest of $219.44, received on bonds at time of sale which is transferred to Line 3, as no tax was paid at source.

b. The cost of securities sold was overstated as follows:

Transamerica (See Exhibit A)	$8,380.06
Columbia Steel (do B)	794.20
Total	$ 9,174.26

c. The deduction for contributions is adjusted as follows:

Income reported	$36,665.51
Addition line 18	9,174.26
Contributions deducted	6,470.39
Total before deduction for contributions	$52,310.16
15% above	7,846.52
Amount deducted	6,470.39
Difference	$ 1,376.13

Corinne S. Koshland

Schedule 2

Year ended 12-31-30

Computation of Tax

Net income from schedule 1		44,463.64
Less: Dividends	$59,641.46	
Interest on Lib. Bonds, etc.	297.50	
Personal exemption and credit dependents	1,500.00	61,438.96
Balance subject to normal tax		None
Surtax on $44,463.64	2,295.64	
		2,295.64
Less: Credit for earned net income from schedule,	None	
Income tax paid at source	74.10	74.10
Total tax assessable		$ 2,221.54
Tax previously assessed		1,388.06
Additional tax to be assessed		$ 833.48

[18]

Corinne S. Koshland

Exhibit A

Cost of Transamerica

		Net cost	Shares sold 1930
		No.	Cost
Bank of Italy purchase	25	11,418.75	
do subn.	10	4,500.00	
rites		.90	
do purchase	40	21,640.00	
Exchanged for B. of I.	300	37,559.65	
Sk. Div.	75		
Subn.	62	11,160.00	
Exchanged for Transamerica			764¾ 48,719.65
Purchased do			¼ 31.25
Baneitaly purchased	10	850.00	
do subn.	22	2,200.00	
" rites		32.80	
" sk. div.	12.8		
" purchased	.2	18.	
" Sk. div.	6 3/7		
Sold	3/7	(26.04)	
Exchanged for Transamerica			51 3,076.74
Received in exchange for Bank of America 2-25-29			48 6,276.00
Market value $130.75			
Apr. 25, 1929 Sk. Div.			8
July 25, 1929 do.			8
Sept. 25, 1929 "			1,320
Oct. do			22
Jan. 1930 "			22
Total sold			2,244 58,103.64
Cost reported			66,483.70
Difference			$ 8,380.06

[19]

Corinne S. Koshland

Exhibit B

Cost of Columbia Steel Pfd.

		Com.		Pfd.	
		No.	Cost	No.	Cost
1 Feb. 28, 1924, pur for	$15,000	750	$ 825.00	150	14,175.
Jan. 31, 1925, Sk. Div. on pfd. in com.	4.889%	127	693.02		(693.02)
Jan. 30, 1926, Sk. Div. on pfd. incom.	8.223%	150	1,108.62		(1,108.62)
2. Mar. 2, 1926, pur for	$ 4,500	750	3,678.89	15	821.11
Feb. 1, 1927, Sk. Div. on pfd. incom.	8.562%	165	1,129.71		(1,129.71)
Jan. 31, 1928, Sk. Div. on pfd. incom.	4.632%	82½	558.96		(558.96)
Total cost pfd.				165	11,505.80
Cost reported					12,300.00
Difference					794.20
1. Cost allocated on basis of market	com.		1.10		
	pfd.		94.50		
2. do	com.		6.25 x 50	312.50	81,753%
	pfd.		69.75 x 1	69.75	18247%

3. The only common that is shown is that which effects the pfd.

[Endorsed]: Filed Apr. 5, 1933. [20]

[Title of Court and Cause.]

ANSWER.

The Commissioner of Internal Revenue by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits, denies and avers as follows:

I. Admits the allegations contained in paragraph I of the petition.

II. Admits the allegations contained in paragraph II of the petition.

III. Admits that the taxes in controversy are income taxes for the calendar year 1930. Denies that the amount in controversy is as alleged in paragraph III of the petition.

IV(a) & (b). Denies that the Commissioner erred as alleged in paragraph IV, sub-paragraphs (a) and (b), of the petition.

(c). Avers that in determining the net taxable income set up in Exhibit B of the petition the Commissioner allowed the sum of $7,846.52 (which sum represents 15% of the amount which the Commissioner determined to be petitioner's net income before deducting contributions) as a deduction on account of contributions, and that if the Board determines that petitioner's net income before deducting contributions is less than the amount determined by the Commissioner, the deduction for contributions should be reduced by 15% of such decrease. [21]

V(a). Admits that the petitioner was the owner of 32 shares of stock of Bank of America, N. A. Admits that prior to the year 1930 said shares of stock were exchanged for 48 shares of stock of Transamerica Corporation. Admits that during the year 1930 petitioner sold said 48 shares of stock of the Transamerica Corporation. Admits that in computing the gain or loss to petitioner with respect to said 48 shares of stock of said Transamerica Corporation the Commissioner used as the cost or other basis thereof the sum of $6,276.00. Avers that peti-

tioner is estopped from claiming a cost or other basis for said stock exceeding the sum of $4,500, in that if petitioner did receive in the year 1929 12 shares of said stock from the Bank of Italy as alleged in the petition the fair market value of said 12 shares of stock was not reported by the petitioner on her 1929 income tax return as a taxable dividend. Denies all other allegations contained in sub-paragraph (a) of paragraph V of the petition.

(b). Admits that in January 1930 165 shares of preferred stock of the Columbia Steel Corporation owned by the petitioner were redeemed for the sum of $17,325. Denies all other allegations contained in sub-paragraph (b) of paragraph V of the petition.

Avers that the petitioner is estopped from claiming a cost or other basis exceeding the sum of $11,505.80 for said 165 shares of preferred stock in that the alleged dividends of January 1925, January 1926, January 1927 and July 1927 were not reported as income on petitioner's 1925, 1926 and 1927 income tax returns. [22]

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the Board redetermine the deficiency for the calendar year 1930 to be equal to the amount determined by the Commissioner, viz. $833.48.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:

F. R. SHEARER,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: Jun. 2, 1933. [23]

[Title of Court and Cause.]

John C. Altman, Esq., for the petitioner.
H. D. Thomas, Esq., for the respondent.

MEMORANDUM OPINION.

LEECH: This proceeding seeks redetermination of a deficiency determined in the amount of $833.48 for the calendar year 1930. Two errors are assigned but one of these was abandoned by the petitioner on the hearing. The remaining issue presents the question of the cost basis, for determination of gain or loss upon the redemption in 1930 for $17,325, of 165 shares of preferred stock of the Columbia Steel Corporation, belonging to petitioner.

Petitioner is a resident of San Francisco, California. The Columbia Steel Corporation, a Delaware corporation, was organized in November, 1922, with an authorized capitalization of 100,000 shares of preferred stock of a par value of $100 per share, and 1,000,000 shares of no [24] par value common stock. Upon organization the corporation acquired, from W. E. Creed, certain properties in consideration of the issuance to him of 39,918.42 shares of its preferred and 547,500 shares of its common stock.

The additional preferred stock of the corporation was offered to the public at par and Creed offered to certain prospective purchasers of this preferred stock, five shares of his common stock for each share of preferred stock they might purchase from the corporation. Petitioner, under this offer, subscribed for 150 shares of preferred stock at par and paid the corporation the sum of $15,000. In subscribing for this stock petitioner understood that she was to receive 150 shares of preferred stock from the corporation and 750 shares of common stock from Creed. This common stock was issued petitioner as agreed upon.

The charter of the corporation authorized the payment of the 7 per cent dividends on the preferred stock, for the first five years of operation, in common stock of the corporation at the rate of one share for each share of preferred. Under this authority the directors declared dividends upon the preferred stock, payable in common stock at the prescribed rate, for the years 1925, 1926, 1927 and 1928. In each of these years the surplus of the corporation was in excess of a 7 per cent dividend upon the issued preferred stock, and, upon the issuance of common stock as a dividend, surplus was, in each instance, debited with an amount at the rate of $7.00 for each share of stock issued and the same amount credited to the common stock account.

In January, 1926, the corporation offered to its stockholders of record the right to subscribe for a specified number of shares of preferred and [25]

common stock in units of one share of preferred and 50 shares of common stock for a price of $300 per unit. Petitioner availed herself of this right and purchased from the corporation 15 units, consisting of 15 shares of preferred stock and 750 shares of common stock.

Petitioner, as the owner of shares of preferred stock of the corporation received shares of common stock representing dividends paid in common stock as follows:

January, 1925	127	shares	common	stock
January, 1926	150	"	"	"
January, 1927	165	"	"	"
January, 1928	82½	"	"	"

During the year 1930, petitioner received the sum of $17,325 in redemption of her 165 shares of preferred stock of the Columbia Steel Corporation. She did not report on her income tax returns for the years 1926 to 1928, inclusive, any amounts as representing the dividends received by her, in common stock of the corporation in those years.

Respondent, in determining the deficiency, appealed from, has treated the original acquisition by petitioner of 150 shares of preferred and 750 shares of common stock, as the purchase of these two blocks of stock for a consideration of $15,000, and has apportioned the sum, paid by petitioner, to the common as well as the preferred stock, on the basis of the relative fair market value of each at the time of acquisition. Respondent has also treated

the dividends received by petitioner in common stock as stock dividends, allocating to the common stock received, in each instance, a proportionate amount of the cost of the preferred stock upon which it was paid. This action has decreased the cost basis of the preferred stock and increased the profit resulting from its redemption. Respondent has also, in determining [26] a cost basis for the 15 shares of preferred stock purchased by petitioner in the exercise of her stock rights, as hereinbefore set out, allocated a proportionate amount of the total payment made for the united of preferred and common stock, to each such class of stock, on the basis of the fair market value of each class of stock at the time of purchase.

Petitioner does not contest the correctness of respondent's determination as to the values of the common stock at the time of the several transactions hereinbefore detailed. She contends that the 150 shares of preferred stock, originally acquired, had a cost basis of $15,000, the 750 shares of common stock received from Creed being in effect a gift, and, that the dividends received by her on her preferred stock, paid in common stock of the corporation, were the equivalent of cash dividends and, consequently, did not reduce the cost basis of the preferred stock. Petitioner urges further that the 15 shares of the preferred stock purchased by her in the exercise of her stock rights had a cost of $100 per share, as the total amount paid for each unit subscribed for should have been allocated, not upon the basis of

the market value of the two classes of stock acquired, but on the basis of $100 for each share of preferred, the balance being the cost of the common stock.

We think it clear that, irrespective of the fact that petitioner acquired her original 750 shares of common stock of the corporation from Creed, and although the total consideration paid by petitioner passed to the corporation, such consideration, in so far as petitioner is concerned, represents the consideration paid by her and therefore the cost to her of both the [27] preferred and common stock acquired. It is undoubtedly true that it was petitioner's intention to acquire 150 shares of preferred and 750 shares of common stock. The only payment was to the corporation but the result of the payment entitled her to receive the common as well as the preferred stock. She would not be entitled to the common stock unless she made such payment. The circumstances of the transaction show clearly that the transfer to her of these 750 shares of common stock by Creed was in no sense a gift, but was in consideration of the payment of $15,000 to the corporation. We think that respondent was correct in holding that, as to this petitioner, the payment made by her of $15,000, represented her cost of the two blocks of stock, common and preferred, which she was entitled to and did receive under the agreements made by her with the corporation and Creed.

The petitioner, in respect to the question of the dividends paid in common stock, relies upon the

Tilotson Manufacturing Co., 27 B. T. A. 913. Respondent attempts to differentiate this case on the facts established in the present record. He calls attention to the fact that the dividend paid in common stock was paid under authority of the charter of the corporation. We see no material distinction in that fact. Whether the action of the directors in paying the preferred dividend in common stock was taken under general or specific authority of the charter or under authority granted by the stockholders is immaterial. Respondent further calls attention to the fact that, under the charter of the corporation, the right existed *in the holders of* preferred stock to convert within a certain period of years, such [28] stock into common stock of the corporation at the rate of 10 shares of common for each share of preferred. He urges that this provision, in effect, makes the preferred stock merely a right to receive common stock and, therefore, not a distinct and separate type of security with rights different from those possessed by the common stock.

With this, we do not agree. Even though the right to convert the preferred stock into common stock existed, the exercise of this right was optional with the stockholder and, if not exercised, the preferred stock remained as such, with rights not possessed by the common stock and different also in that it lacked the voting rights pertaining to the common stock.

After a careful examination of the Tilotson case, supra, we are of the opinion that the question is

controlled by that case, as contended by petitioner, and that the dividends received in common stock did not constitute stock dividends representing the mere dilution of the stockholders' present interest, but were taxable dividends which did not serve to reduce the cost basis of the preferred stock upon which they were paid.

Respondent argues that petitioner is estopped to raise this question by reason of the fact that she has failed to include these dividends in income for the years in which paid. This contention is without merit. There is no indication of deception practiced nor any wrongful act by petitioner, upon which respondent relies, in so treating these dividends on preferred stock. The method with which petitioner treated these dividends in making her returns for the four years in question was the treatment approved by respondent in those years. C. B. IX-1, page 144; C. B. VIII-132. It [29] is clear that there is no ground for an estoppel of petitioner to raise the question here presented. Ohio Brass Co., 17 B. T. A. 1199; United States Trust Co., 13 B. T. A. 1074; Summerfield Co., 29 B. T. A. 77. Cf. Tidewater Oil Co., promulgated February 27, 1934.

In reference to the 15 shares of stock acquired by petitioner as parts of 15 units of preferred and common stock purchased at $300 per unit, it is clear, we think, that the unit cost must be allocated to the two stocks composing such unit, on the basis of the market value of each stock at the time acquired by petitioner, which is the basis used by respondent.

We are concerned with what petitioner received for the payment made by her and this is not controlled by the bookkeeping of the seller in its recording of her payment upon its books in the sum of $100 for each share of preferred stock and $4.00 per share of each share of common stock. The stock was purchased in units, one share of preferred and 50 shares of common. It was sold only in this way and, consequently, what petitioner received were two blocks of stock for a payment of $300 for each unit. Upon this point we sustain the respondent.

Enter:

Judgment will be entered under Rule 50.

[Seal]

[Endorsed]: Entered Mar. 31, 1934. [30]

United States Board of Tax Appeals

Docket No. 70917

CORINNE S. KOSHLAND,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION.

The parties hereto have, under Rule 50, each filed a notice of settlement accompanied by a recomputation of deficiency as in accord with the Memorandum Opinion entered herein March 31, 1934,

and the deficiency as recomputed by each being in the same amount and correct, it is hereby

ORDERED AND DECREED that for the calendar year 1930 there is a deficiency of $502.50

Enter:

[Seal] (Signed) J. RUSSELL LEECH
Member.

Washington, D. C.

[Endorsed]: Entered May 14, 1934. [31]

[Title of Court and Cause.]

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR.

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

NOW COMES, Guy T. Helvering, Commissioner of Internal Revenue, by his attorneys, Frank J. Wideman, Assistant Attorney General, Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, and Harold D. Thomas, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I.

Petitioner on review (hereinafter referred to as the Commissioner) is the duly appointed qualified and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States. The respondent on review is an individual residing in San Francisco,

California, and filed her Federal income tax return for the year 1930 involved herein with the Collector of Internal Revenue for the First District of California at San Francisco, California, and the office of said Collector is located within the judicial circuit of the United States Circuit Court of Appeals for the Ninth Circuit. [32]

II.

The nature of the controversy is as follows:

Respondent on review was the owner of 165 shares of preferred stock of the Columbia Steel Corporation, of which 150 shares had been acquired by her by purchase on February 28, 1924, and 15 shares by purchase on March 2, 1926. As the holder of preferred stock she received her pro rata share of common stock distributed by the corporation in each of the years 1925 to 1928 inclusive, as dividends on the preferred stock. During the taxable year 1930 she received $17,325.00 in redemption of her 165 shares of preferred stock. In determining the profit on the redemption the Commissioner reduced or diminished the original cost basis of such preferred shares by reason of the receipt of the shares of common stock as dividends thereon on the theory that such distributions of common stock were stock dividends, that the original investment is represented not only by the preferred shares but also by the common shares, and that the cost should be apportioned partly to the preferred and partly to the common shares with the result that only the amount apportioned to the preferred shares may be used in determining taxable profit on the redemption of the

latter. The apportionment was made on the basis of the respective values of the preferred stock and common stock at the time of receipt of the latter.

The Commissioner, pursuant to Section 272 of the Revenue Act of 1928, notified Corinne S. Koshland, respondent on review, of his determination of income tax liability for the year 1930 and the respondent on review duly filed a petition with the United States Board of Tax Appeals from the Commissioner's determination for said year. The proceeding was duly heard before the Board. The Board's opinion was promulgated on March 31, 1934, and its decision fixing the amount of tax liability pursuant to the opinion was [33] entered on May 14, 1934.

The Board decided that Corinne S. Koshland, the taxpayer, was entitled to use the original purchase price of the 165 shares as cost in determining profit on the redemption of said shares, while the Commissioner contends that such purchase price should be diminished by apportioning a part of same to the common stock received as dividends on the preferred stock. The aggregate amount which the Commissioner apportioned to the common stock and by which he reduced the original purchase price of the preferred stock was $3,490.31. There is no issue presented as to the amount or basis of apportionment, if apportionment is correct in principle. The Commissioner also contends that the taxpayer, Corinne S. Koshland, is estopped from claiming that no part of the original purchase price should

be apportioned to the common stock received by her by reason of her holdings of preferred stock.

III.

The said Commissioner's assignments of error are as follows:

1. The Board of Tax Appeals erred in holding and deciding that dividends in shares of common stock paid by Columbia Steel Corporation on its preferred stock did not constitute stock dividends.

2. The Board erred in not holding and deciding that dividends in shares of common stock paid by the Columbia Steel Corporation on its preferred stock constituted stock dividends.

3. The Board erred in holding and deciding that, in determining profit on the disposition by the taxpayer in 1930 of her 165 shares of preferred stock of the Columbia Steel Corporation, the cost basis of the preferred stock should not be reduced by reason of dividends thereon received by her in prior years in shares of common stock. [34]

4. The Board erred in not holding and deciding that, in determining profit on the disposition by taxpayer in 1930 of her 165 shares of preferred stock of the Columbia Steel Corporation, the cost basis of the preferred stock should be reduced by reason of dividends thereon received by her in prior years in shares of common stock.

5. The Board erred in failing to find that during the first five years of the existence of the Columbia Steel Corporation the holder of preferred stock

could convert such preferred stock into common stock at the rate of ten shares of common for each share of preferred.

6. The Board erred in holding and deciding that none of the original cost basis of taxpayer's preferred stock of the Columbia Steel Corporation should be allocated to the shares of common stock which she received in prior years as dividends on the preferred stock.

7. The Board erred in not holding and deciding that part of the original cost basis of taxpayer's preferred stock of the Columbia Steel Corporation should be allocated to the shares of common stock which she received in prior years as dividends on the preferred stock.

8. The Board erred in holding and deciding that petitioner was entitled to use a cost basis of shares of preferred stock undiminished by reason of the receipt in prior years of shares of common stock as dividends on preferred stock.

9. The Board erred in not holding and deciding that taxpayer was not entitled to use a cost basis of shares of preferred stock undiminished by reason of the receipt in prior years of shares of common stock as dividends on preferred stock. [35]

10. The Board erred in failing to find that the dividends on preferred stock paid in common stock were designated on the books of the Columbia Steel Corporation as stock dividends.

11. The Board erred in holding and deciding that the receipt by the taxpayer of shares of com-

mon stock of Columbia Steel Corporation by reason of her ownership of preferred shares does not affect the cost basis of the preferred shares in determining profit or the disposition of the latter.

12. The Board erred in not holding and deciding that the receipt by the taxpayer of shares of the Columbia Steel Corporation by reason of her ownership of preferred shares affects the cost basis of the preferred shares in determining profit on the disposition of the latter.

13. The Board erred in not holding and deciding that the taxpayer failed to prove that the distributions of common stock were not proportional redistributions of existing rights and interests of the stockholders.

14. The Board erred in holding and deciding that taxpayer was not estopped from claiming that the cost basis of the shares of preferred stock should not be reduced by reason of the receipt by her of shares of common stock of Columbia Steel Corporation as dividends on the preferred stock.

15. The Board erred in not holding and deciding that taxpayer was estopped from claiming that the cost basis of the shares of preferred stock should not be reduced by reason of the receipt by her of shares of common stock of Columbia Steel Corporation as dividends on the preferred stock.

16. The Board erred in holding and deciding that there is a deficiency [36] in taxes for 1930 of only $502.50.

17. The Board erred in not holding and deciding that there is a deficiency in taxes for 1930 of $833.48.

WHEREFORE, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit, that a transcript of the record be prepared in accordance with law and with the rules of said Court and transmitted to the clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

(Sgd) FRANK J. WIDEMAN,
Assistant Attorney General,
(Signed) ROBERT H. JACKSON,
Assistant General Counsel
for the
Bureau of Internal Revenue.

Of Counsel:
HAROLD D. THOMAS,
Special Attorney,
Bureau of Internal Revenue.

United States of America,
District of Columbia.—ss.

HAROLD D. THOMAS, being duly sworn, says that he is Special Attorney in the office of the Assistant General Counsel for the Bureau of Internal Revenue and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own

knowledge except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

(Sgd) HAROLD D. THOMAS

Sworn and subscribed to before me this 28 day of July, 1934.

(Sgd) MARCELLETTE M. TAYLOR
Notary Public.

My Commission expires March 31, 1935.

[Endorsed]: Filed Aug. 2, 1934. [37]

[Title of Court and Cause.]

NOTICE OF FILING PETITION FOR REVIEW.

To:

Corinne S. Koshland,
3800 Washington Street,
San Francisco, California.

John C. Altman, Esq.,
615 Russ Building,
San Francisco, California.

You are hereby notified that the Commissioner of Internal Revenue did, on the 2nd day of August, 1934, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decision of the Board heretofore rendered in the above-entitled

case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 3rd day of August, 1934.

(Signed) ROBERT H. JACKSON,
Assistant General Counsel
for the
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 13 day of August, 1934.

(Sgd) CORINNE S. KOSHLAND,
Respondent on Review.

(Sgd) JOHN C. ALTMAN,
Attorney for Respondent on Review.

[Endorsed]: Filed Aug. 24, 1934. [38]

[Title of Court and Cause.]

STATEMENT OF EVIDENCE.

The following is a statement of evidence in narrative form in the above-entitled cause. This cause came on for hearing before the Honorable J. Russell Leech, Member of the United States Board of Tax Appeals, on September 18, 1933. John C. Altman, Esq., appeared for the petitioner and E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, appeared for the respondent.

LOUIS SLOSS, JR.

was called as a witness by and on behalf of the petitioner and having been first duly sworn testified as follows:

Direct Examination.

From February 1923 through the year 1928 I was either assistant secretary or secretary of the Columbia Steel Corporation. I am a son-in-law of the petitioner in this action, Corinne S. Koshland. In 1924 the petitioner purchased 150 shares of preferred stock of the Columbia Steel Corporation for which she paid par, $100 a share, a total of $15,000. I was in charge of the stock sales and the stock records at that time and I was familiar in the years 1923 and 1924 with the general set-up, the stock set-up and sales of Columbia Steel Corporation.

Whereupon the witness identified the signature of John D. Fenstermacher, secretary, to the minutes of a meeting of the stockholders of the Columbia [39] Steel Corporation on January 29, 1923 and without objection said minutes were received in evidence as Petitioner's Exhibit No. 1 with privilege of substituting a photostatic copy or another copy thereof. (Photostatic copy of said exhibit attached hereto) [Set out herein at p. 59.] The witness then identified the signature of Mr. Fenstermacher to the minutes of a special meeting of the board of directors of the Columbia Steel Corporation held on January 5, 1925; and also the minutes of a special

(Testimony of Louis Sloss, Jr.)

meeting of the board of directors held on February 18, 1926. Without objection said minutes were received in evidence as Petitioner's Exhibits Nos. 2 & 3 respectively, with right to substitute photostatic copies therefor. (Photostatic copies of said exhibits attached hereto) [Set out herein at pp. 65, 69.] The witness then identified his signature, as secretary, to the minutes of a meeting of the board of directors held on January 17, 1927 and also the minutes of a meeting of the board of directors held on December 19, 1927 and without objection said minutes were received in evidence as petitioner's Exhibits Nos. 4 & 5 respectively, with right to substitute photostatic copies of said exhibits and of any further exhibits. (Photostatic copies of said exhibits attached hereto) [Set out herein at pp. 75, 77.]

The witness then identified Mr. Fenstermacher's signature to the minutes of a meeting of the board of directors held on February 19, 1923, and without objection said minutes, together with the form of certificates for common stock and preferred stock appended thereto and referred to therein was received in evidence as Petitioner's Exhibit No. 6. (Photostatic copy of said exhibit attached hereto) [Set out herein at p. 83.]

The witness on direct examination testified further as follows:

I personally handled the matter of the purchase of these 150 shares of stock in 1924 on behalf of Mrs. Koshland and I arranged for the payment of the $15,000. Mrs. Koshland paid $15,000 to the

(Testimony of Louis Sloss, Jr.)

Columbia Steel Corporation for the 150 shares of stock, $100 a share. As to the source from which Mrs. Koshland received the 750 shares of common stock of the Columbia Steel Corporation, [40] those shares were a portion of the shares allotted to Mr. W. E. Creed by the Columbia Steel Corporation for turning in certain property to the company, the properties of the old Columbia Steel Company, of the Utah Coal & Coke Co., some iron mining property in Utah, and so on. Mrs. Koshland did not have any interest in these various properties Mr. Creed turned over.

Cross Examination.

On cross examination the witness testified as follows:

The Columbia Steel Corporation was formed in the latter part of 1922. Mr. Creed turned over some properties to the corporation and got some stock for it. I know something else about the Columbia Steel Corporation and who all was interested in it. Mr. Creed was the only one who got stock in that particular way. These were some subscribers to stock of the Columbia Steel Corporation on a cash basis and there were former stockholders of the old Columbia Steel. As to whether it was a reorganization, the old Columbia Steel Company was at Pittsburg, California. When the Columbia Steel Corporation was formed it was their idea to go back to the raw materials, making pig iron and changing the pig iron to commercial iron and then proceed-

(Testimony of Louis Sloss, Jr.)

ing with the manufacture. Mr. Creed had an interest in the old Columbia Steel; he was the largest stockholder or the second largest. As to the source of these properties, they had been presented to him by the promoters and he conceived the idea of putting them together. The idea had been given to him and he had contracts covering those properties. When the new company was formed they did not attempt to sell any common stock on the open market; no common stock was sold at all. Mrs. Koshland paid $15,000 to the Columbia Steel Corporation knowing that she was going to get some common stock from Mr. Creed. This same idea was followed out with respect to other subscribers to stock. That is, they would [41] subscribe to some stock and pay over to the corporation a certain amount of money, knowing that they were going to get some preferred stock in the corporation and some common stock from Mr. Creed. The way in which these transactions were carried out was a means of raising new capital. The only common stock which was issued at that time was that which was issued in conjunction with the preferred stock. The company was authorized to issue to Mr. Creek or his nominees, I think it read that way, a certain number of shares of common stock. That was the only common stock that was issued, and upon each purchase of preferred stock Mr. Creed would nominate or name the person to whom that common stock was to go. I want to make this explanation in that regard, that there

(Testimony of Louis Sloss, Jr.)

was common issued in a like manner also to the holders of the old Columbia Steel Company stock who received preferred stock in exchange for the other stock and they received a lesser amount of common stock with each share of preferred. There was only one stock in the old Columbia Steel; that was common stock. They turned their stock in and I believe they received six shares of preferred stock of the Columbia Steel Corporation for each share of stock which they held in the old company. Immediately after the formation of the new Columbia Steel, the preferred stockholders of the company and the common stockholders were approximately the same persons. I believe there was some of the common stock that went for promotion services to one of the Utah men; generally speaking they were the same. As to whether generally speaking each preferred stockholder held so many shares of common stock, I would say there were no preferred members who did not hold any common, but they did not hold it in the same proportion, because some got five shares for each share of preferred and some two shares for each share of preferred. In my testimony as to Mrs. Koshland's purchase of preferred stock for $100 a [42] share, I am referring to what the books show; I am referring to the cash transaction. The corporation didn't have the common; that was already allocated to Mr. Creed. She paid the money in to the corporation, knowing she was going to get so many preferred

(Testimony of Louis Sloss, Jr.)

shares issued by the corporation and so many shares of common to be turned over to her by Mr. Creed.

Redirect Examination.

Upon redirect examination the witness identified the signature of Mr. Fenstermacher, as secretary, to the minutes of a meeting of the board of directors of the Columbia Steel Corporation held on January 29, 1923 and without objection the minutes were received in evidence as Petitioner's Exhibit No. 7 with leave to substitute a photostatic copy thereof. (Photostatic copy of said exhibit attached hereto) [Set out herein at p. 90.]

The witness upon redirect examination testified further as follows:

From the minutes of the meeting of the directors of January 29, 1923 I am able to state that the 750 shares of common stock which Mrs. Koshland received came out of the 547,500 common shares authorized at the meeting to be issued to Mr. Creed, the minutes also authorizing the issuance to Mr. Creed of 39,918.43 shares of preferred stock. I am able to state this because there were no other shares of common stock issued at that time. In other words, that 547,500 shares of common stock were received by Mr. Creed from the corporation in exchange for the transfer of certain stipulated tangible property.

Recross Examination.

Upon recross examination the witness testified:

Mr. Creed was a large stockholder of both the old Columbia Steel and the new Columbia Steel. There

(Testimony of Louis Sloss, Jr.)

may have been one larger stockholder. He owned about 7 or 8 per cent of the securities or stock of the new company. As a [43] substantial stockholder, Mr. Creed was interested in raising additional capital. He was the active head of the company. As regards the old Columbia Steel Company I suppose Mr. Creed was acting for himself and other of the stockholders because he would not have had all the stock available unless he had the consent of the other stockholders. The properties for which stock was issued to Mr. Creed consisted of a mill at Pittsburg, California, and a foundry also at Pittsburg, California, in which steel castings and steel reinforcement bars and so forth were made. The properties of the Utah Coal & Coke Company were located in Carbon County, Utah; the iron mining properties were in Iron County, Utah, near the town of Lund. They were extensive iron and coal properties and their peculiar quality lay in the fact they are the only coal properties so far discovered west of Colorado. No coal had been found in this part of the country from which coke could be made and you have to have a certain amount of that to make pig iron.

The properties just described were turned over by Mr. Creed. Mr. Creed had a contract on those properties with the various owners. One was with the old Columbia Steel holders to turn over their stock. Another was with Mr. Raznis, the representative of the coal people and the other was with

the people who owned the iron mine. As to whether a contract was entered into in the interest of all the old stockholders of Columbia Steel, I could not tell. Those contracts were entered into before I assumed my duties with the corporation but he was the only one named in these contracts.

Redirect Examination

On redirect examination the witness further testified:

Mrs. Koshland did not own any stock in the old Columbia Steel directly or indirectly and had no interest directly or indirectly in any of these [44] properties until she bought the 150 shares of preferred.

C. T. REDMOND

was called as a witness by and on behalf of the petitioner and having been first duly sworn testified as follows:

Direct Examination

I am the assistant secretary of the Columbia Steel Company. I have been employed by the Columbia Steel Corporation, the one we have just been referring to in the testimony of Mr. Sloss. I was first employed by the Columbia Steel Corporation in March, 1924 in the capacity of assistant auditor. I remained assistant for two or three years and then became assistant secretary. During the period from March, 1924 through the year 1928 I was in

(Testimony of C. T. Redmond.)

charge of the books of account of the Columbia Steel Corporation and they were kept under my supervision. I have here the original general ledger covering that period of time. I have the entries in the general ledger with respect to the dividends declared on the preferred stock in January, 1925. There is an entry in the general ledger in January, 1925 with respect to dividends declared on the preferred stock in the form of common stock. The entries show a charge to surplus as of January 31, 1925, and a credit to dividends payable. The charge to surplus represents a dividend in common stock on the preferred stock outstanding at the rate of $7.00 per share. The original records which I have in front of me show the number of shares of common stock with respect to which a dividend was paid on the preferred stock in January, 1925; that was 93,666.611 shares. The amount charged to surplus with respect to those shares is $655,666.28. That represents $7.00 per share on each share of common stock. The other entry was a credit to dividends paid. Further entries were made with respect to this transaction later. On January 31, 1925 an additional entry was made debiting dividends payable in the amount of $655,666.28, crediting common stock $655,417.00 and also crediting [45] acrued dividends payable of $249.28. The last two figures mentioned equal the full amount of the charge to surplus. There was a segregation of that small item of $249.28 because on the computation

(Testimony of C. T. Redmond.)

of the common stock dividend on odd shares at the rate of $7.00 there were fractional shares. These fractional shares were credited to the individual stockholders but not issued at that time. The original books of account of the Columbia Steel Corporation which I have here shows that the surplus of the company which was on hand on January 1, 1925 was $690,807.19. I will give you the same data with respect to the dividend declared on the preferred stock in the form of common stock in January, 1926. The entry as of January 31, 1926 shows a debit to surplus of $663,677.79, and a credit to dividends payable $663,677.79 an additional entry debiting dividends payable $663,677.79 and crediting common stock $663,621.00 and crediting accrued dividends payable $56.79. The explanation as to this little item of $56.79 is the same as that given by me with respect to the other small item for 1925. The records show that the number of shares issued at that time as dividend in common stock on the preferred stock was 94,811.113 shares at the rate of $7.00 per share, or a total of $663,-677.79. The original ledger shows that the surplus of the Columbia Steel Corporation on hand January 1, 1926 was $827,713.80. Turning now to the dividend declared and paid in January, 1927; a charge to surplus $690,233.10; credit dividends payable $690,233.10. The entry was made as of January 31, 1927. The further entry was made charging dividends payable of $690,233.10, and crediting common stock $689,234.00, and crediting accrued dividends

(Testimony of C. T. Redmond.)

payable of $999.10. The total number of shares of common stock involved amounted to 98,604.728 shares at the rate of $7.00 per share or a total of $690,233.10. The explanation with regard to that item of $999.10 was the same as before; that was for fractional shares credited but not issued. The original records show that the surplus of Columbia Steel Corporation on Jan. 1, 1927 was $1,291,017.28. I [46] will give you the same data regarding dividends on January, 1928. As of January 31, 1928 surplus was debited with $349,832.00 and dividends payable credited with $349,832.00. To record the balance of the entry there was a credit to cash and a charge to dividends payable in a like amount, namely, $349,832.00. As to whether the dividend paid in January, 1928 was paid $3.50 per share on the preferred in cash and one-half share of common stock for the balance, there was $3.50 paid in cash and a dividend of common stock at the rate of $3.50 on preferred making a total of $7.00. There were 99,952 shares of common stock issued in connection with the dividend on preferred stock in January, 1928, at the rate of $3.50 per share. The records show that the surplus of the company on January 1, 1928 was $952,317.91. As to how the company credited on its books of account the proceeds of the sale of $3,250,000 par value of preferred stock, I have before me the account in the general ledger designated "Preferred stock unissued". The first debit entry in this account is the record of the

(Testimony of C. T. Redmond.)

authorization of 100,000 shares of seven per cent preferred stock, amounting to $10,000,000. The credit entry in amount, $2,500,000 represents both lists of preferred stock subscriptions received. The books, the original records are silent as to the number of shares of stock that were issued by the corporation in connection with this credit of $2,500,000.

Whereupon the testimony was as follows:

By Mr. ALTMAN:

Q. Then will you please state if you know of your own knowledge what the corporation issued in exchange for the $2,500,000, the credit that you have just mentioned?

A. 25,000 shares of preferred stock at the rate of $100. per share.

Q. Did the corporation issue for the $2,500,000 which appears as a credit on the books anything other than 25,000 shares of its preferred stock? [47]

A. Yes.

Q. What did it issue?

A. Common stock.

Q. For the $2,500,000?

A. No, not for the $2,500,000.

Q. When they issued that $2,500,000 of preferred did they issue any common also?

A. To my knowledge they did not.

By Mr. THOMAS:

Q. Were you with the company during these particular years back in 1924?

(Testimony of C. T. Redmond.)

A. I started March 1924.

Q. What is the date of this entry to which you are testifying?

A. December, 1923.

Q. Then your knowledge of what you have just testified to is gained only from the books and what you have heard somebody else say?

A. Only from the books.

Q. That is all you know, only what the books show?

A. Yes.

The witness on direct examination further testified:

I have the entries in the book with respect to the units of stock that were issued through rights to the stockholders in March 1926. At that time, in March 1926, I was assistant secretary of the company. I was familiar with the fact that the corporation offered to stockholders as shown by the minutes introduced, the right to subscribe to units of stock in units of one share of preferred with fifty of common at the price of $300 per unit. The number of shares of preferred and common that were issued in connection with those units to the stockholders was [48] 4,933 shares of preferred stock at a par value of $100. each and 246,650 shares of common stock at a value of $4.00 per share. The entry was a debit to subscriptions to capital stock, the credit amounting to $1,480,000.00; and a credit to pre-

(Testimony of C. T. Redmond.)

ferred stock unissued of $494,300.00 and a credit to common stock of $986,600.00. The credit to preferred stock was at the rate of $100. per share which was the par value at that time and the credit to common stock was at the rate of $4.00 per share.

Cross Examination.

On cross-examination the witness testified as follows:

As to how the amounts of the debits and credits concerning the dividends on preferred stock payable in common stock are determined, the copy of the resolutions of the board of directors were passed on to the auditors department. The mathematical calculation was at the rate of $7.00 per share of the common on preferred shares outstanding as of that date. It was payable in common stock. The entry represented the amount of preferred stock at $7.00 per share. Turning now to the surplus account of the Columbia Steel Corporation and to the explanation made as of the dates of each of these payments in common stock, I will read the entries:

"January 31, 1925, stock dividend, journal 134, $655,666.28"

"January 31, 1926, stock dividend, journal 198, $663,677.79"

"January 31, 1927, stock dividend, journal 63, $690,233.10"

As to the dividend in 1928, the company had the right to pay in stock up to a certain time, and this

represented the stock dividend up to that time, and the balance was paid in cash. However, the total rate amounted to $7.00 per share, one-half payable in common stock, and one-half in cash. By the time that dividend was paid in 1928 they no longer had the option to pay in stock. [49] In regard to the entry to which I testified showing common stock at $4.00, and preferred stock at $100, it is to record the issuance of stock subscribed during March 1926. That stock was offered to subscribers in blocks, that is, so much common and so much preferred en bloc. Any subscriber at that time had to buy both preferred and common. The correspondence between the corporation and the stockholders at that time regarding their right to subscribe to this stock was a letter to the stockholders dated "Provo, Utah, February 9, 1926." The letter reads as follows:

> "At a special meeting of the stockholders of the corporation held on February 8, 1926, the articles of the corporation were amended, increasing the total number of shares authorized of the corporation's common capital stock to 1,500,000 shares. In accordance with the plan outline in the notice calling this meeting, your directors, authorized the sale of 5,000 shares of preferred stock and 250,000 shares of common stock of the corporation in units of one share of preferred and fifty shares of common stock at a price of $300 per unit, to be offered ratably to stockholders of the corporation of record on February 1, 1926, at noon.

(Testimony of C. T. Redmond.)

"Each stockholder is entitled to ten rights for each share of preferred stock and one right for each share of common stock so held.

"You are entitled to a subscription right for these units in accordance with your holdings as follows:

"Each 376 rights entitle you to subscribe to one unit. If you would be entitled to subscribe for a fraction of a unit you may subscribe for a whole unit. Subscriptions for fractions of a unit will not be accepted." [50]

That letter was sent to the stockholders of the Columbia Steel Corporation on or about the date the letter bears.

Redirect Examination.

Upon redirect examination the witness testified: I have the entry in connection with the dividend that was paid in January 1928, half in cash and half in stock. There were 99,952 shares of common stock issued at three-fifty per share; of course they would have to be divided by two. What I really mean is, it would be just half of that. It works out at the rate of $3.50. As to the whole number of shares issued at that time, that 99,952 figure would be reduced exactly in half. And in addition to getting one-half a share of common stock for the year just ended the stockholders of preferred stock received $3.50 in cash. The entry was "January 31, 1928, Cash dividend on preferred stock, journal

(Testimony of C. T. Redmond.)

228, $349,832." I wish to correct my testimony on that January 1928 dividend; the entry was made in the surplus account on December 31, 1927. The entry in the surplus reads—debit to surplus, $699,-184.18, and a credit to dividends payable of $699,-184.18 to record the preferred stock dividend declared by the board of directors on December 19, 1927 payable in part common stock, one-half common stock and one-half preferred. By one-half common stock I mean that the preferred dividend occurred for the entire year 1927; 1927 was payable partly in cash, $3.50 per share or a total of $349,-651.79 in cash, and in addition one-half of a share of common stock for each share of preferred stock held. The number of shares of common stock actually issued per half share of common for each share of preferred was 49,933.198 shares at $7.00 per share or a total of $349,532.39. When I was testifying before as to that $349,532.00 figure, that was an error covering January 1928. [51]

Recross Examination.

The witness upon recross examination testified:

I read into the record a while ago a letter dated February 9, 1926 to the stockholders. As a result of that letter certain moneys were paid into the corporation for blocks of stock; both preferred and common, in one block.

STIPULATION.

The testimony of the witness having been concluded, counsel for the respective parties orally stipulated into the record the following facts:

At all times material to this proceeding, the par value of preferred stock of Columbia Steel Corporation was $100.00 per share, the common stock of the Columbia Steel Corporation had no par value, and the preferred stock had no voting rights.

The petitioner, Corinne S. Koshland, as a result of her ownership of shares of preferred stock of the Columbia Steel Corporation received the following dividends in shares of common stock, namely, in January 1925, 127 shares of common stock; in January 1926, 150 shares of common stock; in January 1927, 165 shares of common stock; in January 1928, 82½ shares of common stock; all of Columbia Steel Corporation.

The petitioner, Corinne S. Koshland, did not report on her income tax returns any amounts for the dividends received by her in common stock of the Columbia Steel Corporation in the years 1925, 1926, 1927 and 1928. [52]

PETITIONER'S EXHIBIT NO. 1

MINUTES OF SPECIAL MEETING OF STOCKHOLDERS OF COLUMBIA STEEL CORPORATION, HELD JANUARY 29TH, 1923.

Pursuant to the call of the board of directors, a special meeting of the stockholders of Columbia

Steel Corporation was held at room 1205 of the Balfour Building, number 351 California Street, San Francisco, on January 29th, 1923, at two-thirty o'clock p. m.

There were represented in person or by proxy 66,403.42 shares of the preferred capital stock, being more than a majority of the issued or subscribed preferred capital stock of the corporation, and 535,000 shares of the common capital stock, being all the issued or subscribed common capital stock of the corporation.

President W. E. Creed presided as Chairman of the meeting, and John D. Fenstermacher acted as secretary. The secretary then reported that notice of this meeting had been given to each and every stockholder of the corporation by depositing in the United States Postoffice at San Francisco, California, on January 18, 1923, being more than ten days before the time set for this meeting, a written notice, with postage thereon fully prepaid, addressed to each of the holders of the common stock and to each of the holders of the preferred stock, at the Postoffice address of such respective stockholders, which written notice is in words and figures following: [53]

"TO THE STOCKHOLDERS OF COLUMBIA STEEL CORPORATION:

Please be advised that by resolution passed by the Board of Directors of Columbia Steel Corporation on the 18th day of January, 1923, a special meeting of the stockholders of said

Columbia Steel Corporation has been called for, and will be held on, Monday the 29th day of January, 1923, at the hour of two-thirty o'clock p. m., at the office of said corporation, room 1205 of the Balfour Building, #351 California Street, San Francisco, California, for the consideration of a proposition to amend the charter of incorporation of said Columbia Steel Corporation by changing the common stock of said corporation from 1,000,000 shares of the par value of $10.00 each to 1,000.000 shares without nominal or par value; and for the transaction of such other business as may come before said meeting.

Dated January 18th, 1923, by order of the Board of Directors.

JOHN D. FENSTERMACHER,
Secretary of Columbia Steel
Corporation."

On motion, duly made, seconded and carried, the notice of the meeting given by the secretary was duly approved.

The secretary read the resolution of the board of directors, passed at its meeting held on the 18th day of January, 1923, and thereupon Jos. Sloss, one of the stockholders, introduced the following resolution and moved its adoption:

"RESOLVED: That the charter of incorporation of this corporation, Columbia Steel Corporation, be amended to read as follows:

(Here follows the amended certificate of incorporation of Columbia Steel Corporation, as set forth on pages ..... to ..... of these minutes.)"

The motion for the adoption of said resolution was seconded by D. H. Botchford.

Thereupon, on motion duly made, seconded and carried by the vote of all the stock represented at said meeting, and by the vote of all the common stock represented at said meeting, and by the vote of all the preferred stock represented at said meeting, E. F. Burrell and C. G. Dall were appointed Judges to conduct the vote of the stockholders to be taken for [54] or against the proposed amendment. Thereupon, said Judges decided upon the qualification of voters, and decided that all the stockholders hereinbefore named were entitled to vote the number of shares of prefered stock and the number of shares of common stock set after their respective names. Thereupon, the vote of said stockholders was taken by ballot and such votes were accepted by said Judges, and when the vote was completed, said votes were counted by said Judges, and said Judges counted and ascertained the number of shares voted respectively for and against said amendment, and ascertained that the number of shares voted for said amendment was:

Preferred Stock ..... 66,403.42 Shares
Common Stock ..... 535,000.00 Shares

and that the number of shares voted against said amendment was:

Preferred Stock ..... None
Common Stock ..... None

The said Judges, thereupon, declared that the persons or bodies corporate holding the majority of the voting stock of said corporation had voted for the proposed amendment, and that the persons or bodies corporate holding the majority of the preferred stock of said corporation had voted for said amendment, and that the persons or bodies corporate holding the majority of the common stock of said corporation had voted for said amendment. And, thereupon, said Judges made out certificates accordingly in duplicate, stating the number of shares of stock issued and outstanding entitled to vote, and the number of shares voted for, and the number of shares voted against, the amendment, respectively, and did subscribe and deliver the said certificates to the Secretary of the corporation.

The Chairman, thereupon, announced that the resolution for the amendment of the charter of incorporation of this corporation had been adopted by the vote of the persons or bodies corporate holding the majority of the preferred stock of this corporation and by the vote of the persons or bodies corporate [55] holding a majority of the common stock of this corporation, and declared said proposition for the amendment of said certificate to be carried and approved.

Thereupon, W. I. Brobeck introduced the following resolution and moved its adoption:

> "WHEREAS the board of directors of this corporation, Columbia Steel Corporation, at a meeting held this day, duly passed a resolution

creating a bonded indebtedness, which resolution has been read to this meeting,

NOW, THEREFORE, BE IT RESOLVED: That the action of said board of directors in passing said resolution and in the creation of said bonded indebtedness be, and it is hereby, in all things, approved, ratified and confirmed."

The motion for the adoption of said resolution was seconded by L. F. Rains and upon being put to a vote was unanimously carried.

Thereupon, L. F. Rains introduced the following resolution and moved its adoption:

"WHEREAS the board of directors of this corporation, Columbia Steel Corporation has authorized a bond issue of this corporation in the total sum of $10,000,000.00 and has ratified a contract with Dillon, Read & Co., Anglo-London-Paris Company, Mercantile Securities Company, Anglo-California Trust Company and Union Trust Company of Cleveland, Ohio, for the sale to them of $4,000,000.00 face value of said bonds on terms and conditions approved by said board of directors,

NOW, THEREFORE, BE IT RESOLVED: That the said sale and the contract therefor, as aforesaid, be and the same is hereby in all things fully ratified, approved and confirmed."

The motion for the adoption of said resolution was seconded by Jos. Sloss and upon being put to a vote was unanimously carried.

The meeting thereupon, on motion, adjourned.

JOHN D. FENSTERMACHER,
Secretary.[56]

PETITIONER'S EXHIBIT NO. 2

MINUTES OF SPECIAL MEETING OF BOARD OF DIRECTORS OF COLUMBIA STEEL CORPORATION HELD JANUARY 5TH, 1925.

A special meeting of the Board of Directors of the Columbia Steel Corporation was held at the office of the Corporation at San Francisco, California, Room 1222 of the Balfour Building, 351 California Street, on Monday, the 5th day of January, 1925.

Present:

Directors Alexander, Botchford, Creed, Crocker, Drum, Grant, Morse and Sloss.

Mr. Fenstermacher in attendance.

Absent:

Directors Armstrong, Ellis, Fleishhacker, Hammon, Llewellyn, Rains and Taylor.

MEETING CALLED TO ORDER:

President Creed took the chair and called the meeting to order.

READING OF THE MINUTES:

The minutes of the meeting held December 29th, 1924, were read and upon motion duly made, seconded and carried, were approved and ratified.

COMBINED WEEKLY REPORT:

The Combined Weekly Report for the week ending January 3rd, was submitted to the Board.

SALES REPORT:

Weekly report of orders received was submitted to the Board.

OPERATIONS:

Manager Botchford gave the Board an oral report covering all operations of the Corporation.

PREFERRED STOCK DIVIDEND:

Director Grant introduced the following resolution and moved its adoption:

> "RESOLVED: That on January 31, 1925, a dividend be paid to the holders of record of the preferred stock of this corporation on December 31, 1924, at noon, at the rate of one share of common stock per annum on each share of preferred stock for the year 1924, except that where preferred stock was originally issued after January 1, 1924, the dividend shall be pro rata at the rate of one share of common stock per annum on each share of preferred stock for the period from the respective dates of issuance of said preferred stock to January 1, 1925; and
>
> FURTHER RESOLVED: That in the payment of said dividend, certificates be issued for whole numbers of shares only and that fractions [57] of shares, if any, be carried to the credit of the respective stockholders on the books of this corporation."

Said resolution was seconded by Director Crocker and upon being put to a vote was unanimously carried.

SAN FRANCISCO CHAMBER OF COMMERCE:

Upon motion made by Director Alexander and seconded by Director Sloss, it was duly moved, seconded and carried to have this Corporation carry fifteen (15) Class "A" Memberships in the San Francisco Chamber of Commerce for the year of 1925 at a total cost for same of Nine Hundred Dollars ($900.00).

BANK OF CALIFORNIA:

Director Sloss introduced the following resolution and moved its adoption:

"BE IT RESOLVED That this corporation, Columbia Steel Corporation, created under the laws of the State of Delaware, borrow, from time to time, from The Bank of California, National Association, of San Francisco, (hereinafter designated as the "Bank") such sum or sums of money as the person, or any of the persons, hereinafter named, may deem proper, not exceeding, however, in the aggregate, at any time, the sum of Six Hundred Thousand Dollars ($600,000.00); that Wigginton E. Creed, President, and John D. Fenstermacher, Secretary, or Louis Sloss, Jr., Assistant Secretary, are hereby authorized to execute and deliver for, on behalf of and in the name of this corporation, as evidence of indebtedness so created, promissory notes or other commercial paper, negotiable or non-negotiable, in such form, bearing such rate of interest and containing such

other terms and conditions as may be required by the Bank; and

"Be it further RESOLVED that the person, or any one of the persons, hereinbefore named, is hereby authorized for, on behalf of and in the name of this corporation, from time to time, to pledge with the Bank, for the purpose of securing any present or future indebtedness of this corporation to the Bank, personal property of this corporation; to execute such contracts of pledge, general or special, as the Bank may require; and to endorse and deliver to the Bank, for any purpose and to any amount, commercial paper of any kind, negotiable or non-negotiable, executed by others and owned or held by, or payable to this corporation; and

"Be it further RESOLVED that all commercial paper of any kind, negotiable or non-negotiable, and all contracts of pledge or guaranty, now held by the Bank and made, endorsed, accepted or executed in the name of this corporation by the person, or any of the persons, hereinbefore named, are hereby recognized and declared to represent obligations of this corporation; and

"Be it further RESOLVED that nothing herein contained shall be deemed to affect the authority, heretofore or hereafter conferred by this corporation, upon any other person or persons, and

"Be it further RESOLVED that the authority herein conferred shall continue in full

force and effect until written notice of its revocation shall have been given to the Bank at its banking house at San Francisco." [58]

Said resolution was seconded by Director Drum and upon being put to a vote was unanimously carried.

ADJOURNMENT:

No further business appearing before the Board, on motion duly made, seconded and carried, the meeting adjourned.

JOHN D. FENSTERMACHER,
Secretary. [59]

PETITIONER'S EXHIBIT NO. 3

MINUTES OF REGULAR MEETING OF BOARD OF DIRECTORS OF COLUMBIA STEEL CORPORATION HELD JANUARY 18, 1926.

A regular meeting of the Board of Directors of the Columbia Steel Corporation was held at the office of the Corporation at San Francisco, California, Room 1222 of the Balfour Building, 351 California Street, on Monday, the 18th day of January, 1926.

Present: Directors Creed, Crocker, Drum, Grant, Hammon, Morse, Rains, Sloss and Taylor.

Absent: Directors Alexander, Armstrong, Botchford, Ellis, Fleishhacker and Llewellyn.

READING OF THE MINUTES:

The minutes of the regular meeting held December 21, 1925, were read, and upon motion duly made,

seconded and carried, were approved and ratified.

COMBINED WEEKLY REPORT:

A combined weekly report for the week ending January 11, 1926, was submitted to the Board.

OPERATIONS:

Vice-President Rains gave the Board an oral report on the Utah operations of the Corporation.

Secretary Fenstermacher gave the Board a report on the sales operations of the Corporation.

EXECUTIVE COMMITTEE:

On motion made by Director Morse and seconded by Director Taylor, it was duly moved, seconded and caried that all the acts and actions of the Executive Committee, as set forth in the minutes of the meetings of said Committee of December 28, 1925, and January 4, 8, and 11, 1926, be and they are hereby ratified and approved.

CONSOLIDATED BALANCE SHEET:

Preliminary figures of earnings for the month of December, 1925, were presented by the President, and earnings for the year 1925, were discussed. It was stated that adjustments of reserves would increase the annual figures as presented. [60]

"FURTHER RESOLVED: That a meeting of all the stockholders of Columbia Steel Corporation entitled to vote, be and the same is hereby called to be held on Monday, the 8th day of February, 1926, at the hour of two o'clock in the afternoon of said day, at the office of said Columbia Steel Corporation, room 622 of the Matson Building, number 215 Market Street, San Francisco, California, for the considera-

tion of said proposed amendment, and the secretary of this corporation is hereby directed to give notice to said stockholders of said meeting in accordance with the by-laws of this corporation."

The motion for the adoption of said preamble and resolution was seconded by Director Morse, and upon being put to a vote was unanimously carried.

Director Drum introduced the following resolution and moved its adoption:

"WHEREAS this corporation, Columbia Steel Corporation, is indebted to banks in the sum of One million five hundred and fifty thousand dollars ($1,550,000) as a current indebtedness, and it seems desirable forthwith to liquidate and discharge this indebtedness;

"NOW, THEREFORE, BE IT RESOLVED, that when the Charter of Incorporation of this corporation shall have been amended to increase the total number of shares authorized of the corporation's common capital stock from 1,000,000 shares to 1,500,000 shares, the corporation offer and sell to its stockholders five thousand (5,000) units of stock as follows:

"Each unit shall consist of one share of preferred stock and fifty shares of common stock, and the price of each of said units shall be Three Hundred Dollars ($300); and

"FURTHER RESOLVED that the proceeds received from the sale of said stock units be used forthwith. With other funds of the company to liquidate and discharge its entire floating indebtedness; and

"FURTHER RESOLVED that said units of stock be offered to stockholders of record on February 1, 1926, at noon, pro rata on the basis of one unit for every 376 rights to which the respective stockholder shall be entitled, each stockholder being entitled to ten rights for each share of preferred stock and one right for each share of common stock, so held of record, provided that where any stockholder would be entitled to subscribe for a fraction of a unit, he shall be permitted to subscribe for a whole unit and that subscriptions for fractions of a unit shall not be accepted; and

"FURTHER RESOLVED that subscription rights shall expire on March 31, 1926, and the certificates of stock to be issued pursuant to this resolution be executed in the State of Utah, by L. F. Rains, Vice-President of this corporation, and W. C. Miller, Assistant Secretary of this corporation, and that such certificates be delivered by said officers in the State of Utah; and

"FURTHER RESOLVED that the President be authorized to cause such notices to be sent and such measures to be taken as will consummate the objects and purposes of this resolution; and

"FURTHER RESOLVED that the stock transfer books be closed from this date to February 1, 1926, at noon."

The motion for the adoption of said resolution was seconded by Director Grant, and upon being put to a vote was unanimously carried.

Director Sloss introduced the following resolution and moved its adoption: [61]

"RESOLVED: That on January 30, 1926, a dividend be paid to the holders of record of the preferred stock of this corporation, Columbia Steel Corporation, on December 31, 1925, at noon, for the year 1925, at the rate of one share of common stock per annum on each share of preferred stock; and

"FURTHER RESOLVED: That, in the payment of said dividend, certificates be issued for whole numbers of shares only and that fractions of shares, if any, be carried to the credit of the respective stockholders on the books of this corporation; and

"FURTHER RESOLVED: That, where fractions of shares so carried to the credit of a stockholder on the payment of this dividend when added to fractions of shares heretofore carried to the credit of such stockholder shall equal a whole share or multiples thereof, certificates be issued for such whole number of shares; and

"FURTHER RESOLVED: That the certificates of stock to be issued pursuant to this resolution be executed in the State of Utah by L. F. Rains, Vice-President of this Corporation, and W. C. Miller, Assistant Secretary of this corporation, and that said certificates be delivered by said officers in the State of Utah."

The motion for the adoption of said resolution was seconded by Director Morse, and upon being put to a vote was unanimously carried.

Director Sloss introduced the following resolution and moved its adoption.

> "RESOLVED: That the office of this corporation, Columbia Steel Corporation, in San Francisco, California, be, on February 1, 1926, moved to and established at Room Number 622 of the Matson Building, 215 Market Street, San Francisco, California."

The motion for the adoption of said resolution was seconded by Director Taylor, and upon being put to a vote was unanimously carried.

Director Sloss introduced the following resolution and moved its adoption:

> "RESOLVED: That this corporation, Columbia Steel Corporation, waive all interest for the years 1924 and 1925 on moneys advanced by this corporation to Carbon County Railroad Company, a corporation."

The motion for the adoption of said resolution was seconded by Director Taylor and upon being put to a vote was unanimously carried.

ADJOURNMENT:

No further business appearing before the Board, on motion duly made, seconded and carried, the meeting adjourned.

JOHN D. FENSTERMACHER,
Secretary.[62]

PETITIONER'S EXHIBIT NO. 4

MINUTES OF MEETING OF BOARD OF DIRECTORS OF COLUMBIA STEEL CORPORATION HELD JANUARY 17, 1927.

A regular meeting of the Board of Directors of the Columbia Steel Corporation was held at the office of the Corporation at San Francisco, California, Room 600 of the Matson Building, 215 Market Street, San Francisco, California, on Monday, January 17, 1927, at 2:00 P. M.

Present: Directors Creed, Crocker, Drum, Hammon, Morse and Sloss.

Absent: Directors Alexander, Armstrong, Botchford, Ellis, Fleishhacker, Grant, Llewellyn, Rains and Taylor.

MEETING CALLED TO ORDER:

President Creed took the chair and called the meeting to order.

READING OF THE MINUTES:

The minutes of the meeting held January 10, 1927, were read, and upon motion duly made, seconded and carried, were approved.

COMBINED WEEKLY REPORT:

The Combined Weekly Report for the week ending January 10, 1927 was submitted to the Board.

EXECUTIVE COMMITTEE:

On motion made by Director Morse and seconded by Director Hammon it was duly moved, seconded and carried that all acts and actions of the Executive Committee as set forth in the minutes of

January 3rd and January 10th, 1927, be and are hereby ratified and approved.

SALES:

Mr. Fenstermacher gave the Board an oral report of current sales conditions.

RESOLUTION RE STOCK DIVIDEND:

On motion of Director Drum, seconded by Director Crocker, it was

RESOLVED, That on January 31, 1927, a dividend be paid to the holders of record of the preferred stock of this corporation, Columbia Steel Corporation, on December 31, 1926, at noon, for the year 1926, at the rate of one share of common stock per annum on each share of preferred stock; and [63]

FURTHER RESOLVED: That, in payment of said dividend, certificates be issued for whole numbers of shares only and that fractions of shares, if any, be carried to the credit of the respective stockholders on the books of this Corporation; and

FURTHER RESOLVED: That, where fractions of shares so carried to the credit of the stockholder on the payment of this dividend when added to fractions of shares heretofore carried to the credit of such stockholder shall equal a whole share or multiples thereof, certificates be issued for such whole number of shares.

FURTHER RESOLVED: That the certificates of stock to be issued pursuant to this resolution be executed in the State of Utah by L. F.

Rains, Vice-President of this Corporation, and W. C. Miller, Assistant Secretary of this Corporation, and that said certificates be delivered by said officers in the State of Utah.

PURCHASE OF ALCOHOL:

On motion of Director Morse, seconded by Director Sloss, it was

RESOLVED: That President W. E. Creed be and is hereby authorized to sign application for permission to purchase and use alcohol under the National Prohibition Act, such alcohol being for use in the various laboratories of this Company.

BUSINESS FOR YEAR 1926:

President Creed presented to the Board a statement of the estimated profits for the month of December and for the year 1926.

ADJOURNMENT:

No further business appearing before the Committee, on motion duly made, seconded and carried, the meeting adjourned.

LOUIS SLOSS, JR.,
Secretary. [64]

PETITIONER'S EXHIBIT NO. 5

MINUTES OF MEETING OF BOARD OF DIRECTORS OF COLUMBIA STEEL CORPORATION HELD DECEMBER 19, 1927.

A regular meeting of the Board of Directors of Columbia Steel Corporation was held at the office

of the Corporation, 622 Matson Building, 215 Market Street, San Francisco, California, on Monday, December 19, 1927, at 2:00 P. M.

Present: Directors Alexander, Armstrong, Crocker, Dall, Drum, Ellis, Fleishhacker, Grant, Hammon, Llewellyn, Kinney and Rains.

Absent: Directors Botchford, Sloss and Taylor.

MEETING CALLED TO ORDER:

President Grant took the chair and called the meeting to order.

READING OF THE MINUTES:

The minutes of the meeting held November 21, 1927 were read and upon motion duly made and carried, were approved.

COMBINED WEEKLY REPORT:

The Combined Weekly Report for the week ending December 12, 1927 was presented to the Board.

SALES:

An oral report on current sales conditions was made to the Board by Mr. Fenstermacher.

EXECUTIVE COMMITTEE ACTIONS:

On motion of Director Alexander, seconded by Director Kinney, it was duly moved, seconded and carried that all acts and actions of the Executive Committee as set forth in the minutes of meetings held November 28th, December 5th and December 12th, be and are hereby ratified and approved.

RESOLUTIONS RE PITTSBURG COTTAGE TO RUSSELL V. AND FRANCES M. WHIPPLE:

On motion of Director Drum, seconded by Director Hammon, it was

RESOLVED, that WHEREAS this corporation has contracted to sell [65] and convey to Russell D. Whipple and Frances M. Whipple, his wife, that certain real property situate in the City of Pittsburg, County of Contra Costa, State of California, and described as follows, to-wit:

Lot numbered twelve (12) in block numbered ninety (90), as said lot and block are shown, delineated and so designated on that certain map entitled: "Amendment No. 1 Official Map of the City of Pittsburg, Contra Costa Co., Cal.", which said map was filed for record in the office of the County Recorder of the County of Contra Costa, State of California, on January 17th, 1919, in Volume 16 of Map Books, at page 357;

for the sum of $2,850; and

WHEREAS said real property so sold is a portion of the real estate described as Parcel 2 in that certain indenture executed by this corporation to American Trust Company, as trustee, dated as of the first day of June, 1927; and

WHEREAS the price obtained for the sale of said property is the fair and reasonable value thereof and the consideration received therefor,

less such portion of the consideration as was paid to this corporation prior to the date of said indenture, is the sum of $266.64; and

WHEREAS this corporation has the right as provided in Section 2 of Article Sixth of said indenture to sell and convey said real property freed from the encumbrances and trust of said indenture upon payment to said trustee of said sum of $266.64 and upon obtaining the express consent in writing of the trustee;

NOW, THEREFORE, BE IT RESOLVED: That said sum of $266.64 be paid to the trustee under said indenture and that said trustee be requested to release under its seal from the operation and effect of said indenture said real property hereinbefore described.

FURTHER RESOLVED: That, upon obtaining the express consent in writing of said trustee, J. D. Grant, president of this corporation, or D. H. Botchford, vice-president of this corporation, and Louis Sloss, Jr., secretary of this corporation, or C. T. Redmond, assistant secretary of this corporation, be, and they are hereby, authorized to execute in the name of this corporation and deliver to said Russell D. Whipple and Frances M. Whipple a deed to said real property in performance of said contract upon full payment of said purchase price.

NOVEMBER OPERATIONS:

An estimate of profit for the month of November was presented to the Board by President Grant. [66]

RESOLUTION RE DIVIDEND FOR 1927:

On motion of Director Fleishhacker, seconded by Director Llewellyn, it was

RESOLVED, that on January 31, 1928, a dividend be paid to the holders of record of the preferred stock of this Corporation, Columbia Steel Corporation, at the close of business on December 20, 1927, for the period commencing January 1, 1927, and ending June 30, 1927, at the rate of one-half share of common stock for said period on each share of preferred stock; and

FURTHER RESOLVED, that in payment of said dividend certificates be issued for whole numbers of shares only and that fractions of shares, if any, be carried to the credit of the respective stockholders on the books of said corporation; and

FURTHER RESOLVED, that where fractions of shares so carried to the credit of a stockholder on the payment of this dividend, when added to fractions of shares heretofore carried to the credit of such stockholder, shall equal a whole share or multiples thereof, certificates be issued for such whole number of shares, but that where there shall remain to the credit of a stockholder a fraction of a share only, there be paid to such stockholder, in satisfaction of his right to such fractional share, a sum of money equal to the value of said frac-

tional share computed at the rate of seven dollars ($7.00) per share; and

FURTHER RESOLVED, that the certificates of stock to be issued pursuant to this resolution be executed in the State of Utah by L. F. Rains, vice-president of this corporation, and W. C. Miller, assistant secretary of this corporation, and that said certificates be delivered by said officers in the State of Utah; and

FURTHER RESOLVED: that on January 1, 1928, a dividend be paid to the holders of record of the preferred stock of this corporation at the close of business on December 20, 1927, for the period commencing July 1, 1927 and ending December 31, 1927, at the rate of three dollars and fifty cents ($3.50) for said period on each share of preferred stock; and

FURTHER RESOLVED, that no transfer of said preferred stock shall be made between close of business on December 24, 1927, and the opening of business on January 3, 1928, and that the preferred stock transfer books of the corporation be closed during said period.

RESIGNATION OF D. H. BOTCHFORD:

President Grant presented to the Board the resignation as vice president, general manager and director of the Company, of Mr. D. H. Botchford, which resignation was accepted by the Board.

EXECUTIVE COMMITTEE:

On motion of Director Crocker, seconded by Director Dall, it was

RESOLVED, to increase the number of directors serving on the Executive Committee to eight (8). President Grant appointed Director Ralph W. Kinney to fill the additional place created on the Executive Committee. [67]

PETITIONER'S EXHIBIT NO. 6

MINUTES OF REGULAR MEETING OF THE BOARD OF DIRECTORS OF COLUMBIA STEEL CORPORATION HELD FEBRUARY 19TH, 1923.

A regular meeting of the board of directors of Columbia Steel Corporation was held at the office of the corporation at San Francisco, California, room 1205 of the Balfour Building, number 351 California Street, at two o'clock p. m. on Monday the 19th day of February, 1923.

Present: Directors Alexander, Boynton, Burrell, Creed, Crocker, Dall, Drum, Grant, Morse and Sloss.

Absent: Directors Armstrong, Botchford, Ellis, Fleishhacker and Rains.

President Creed presided.

The minutes of the directors meeting held January 29th, 1923, were read and on motion duly made, seconded and carried approved.

President Creed then presented to the meeting an offer made by him on behalf of Columbia Steel Corporation to Llewellyn Iron Works, embodied in a letter dated February 15th, 1923, reading as follows:

"February 15, 1923.

Llewellyn Iron Works,
Los Angeles, California.

Gentlemen:

Attention of Mr. Reese Llewellyn,
President.

This letter will serve to confirm the arrangement made between the Llewellyn Iron Works, represented by Mr. Waller Taylor and Mr. Benjamin Harwood, and the Columbia Steel Corporation, represented by Mr. D. H. Botchford, that Llewellyn Iron Works will form the Llewellyn Steel Corporation, and will transfer to it the plant site of Llewellyn Iron Works of about twenty-five acres at Torrance, California, together with all the buildings and equipment located thereon, and the office buildings and land adjoining the plant site, together with said Torrance plant's business, good will and all orders upon the books. [68]

The Llewellyn Iron Works agrees to transfer to Columbia Steel Corporation 650 shares of the Steel Mill & Foundry Supply Company, for which Columbia Steel Corporation agrees to pay $50.00 per share.

We believe this covers all things regarding this transaction.

Yours very truly,

W. E. CREED,
President.

Approved by the Executive Board of the Columbia Steel Corporation, February 12th, 1923.

Accepted by

LLEWELLYN IRON WORKS,

.....

President.

.....

On motion of Director Alexander, seconded by Director Crocker, the action of the president in making such offer to Llewellyn Iron Works was ratified and approved.

Director Sloss introduced the following resolution and moved its adoption:

"RESOLVED: That a certificate bearing the words 'Form of Common Stock Certificate, under Amended Charter. Cancelled' and a certificate bearing the words 'Form of Preferred Stock Certificate under Amended Charter. Canceled', and each identified by the impression of the corporate seal of this corporation thereon, be and the same are hereby adopted as the form of certificates to be issued to the common stockholders and to the preferred stockholders respectively of this corporation, Columbia Steel Corporation, under its Amended Certificate of Incorporation, and the secretary is instructed to insert a copy of said certificates in the minute book at the place where this resolution appears for the purpose of identifying said certificates."

Said resolution was seconded by Director Burrell and upon being put to a vote was unanimously carried.

There being no further business, on motion duly made and carried, the meeting adjourned.

JOHN D. FENSTERMACHER,
Secretary. [69]

COMMON STOCK

CERTIFICATE

For Shares

Issued to

Dated 19

FROM WHOM TRANSFERRED

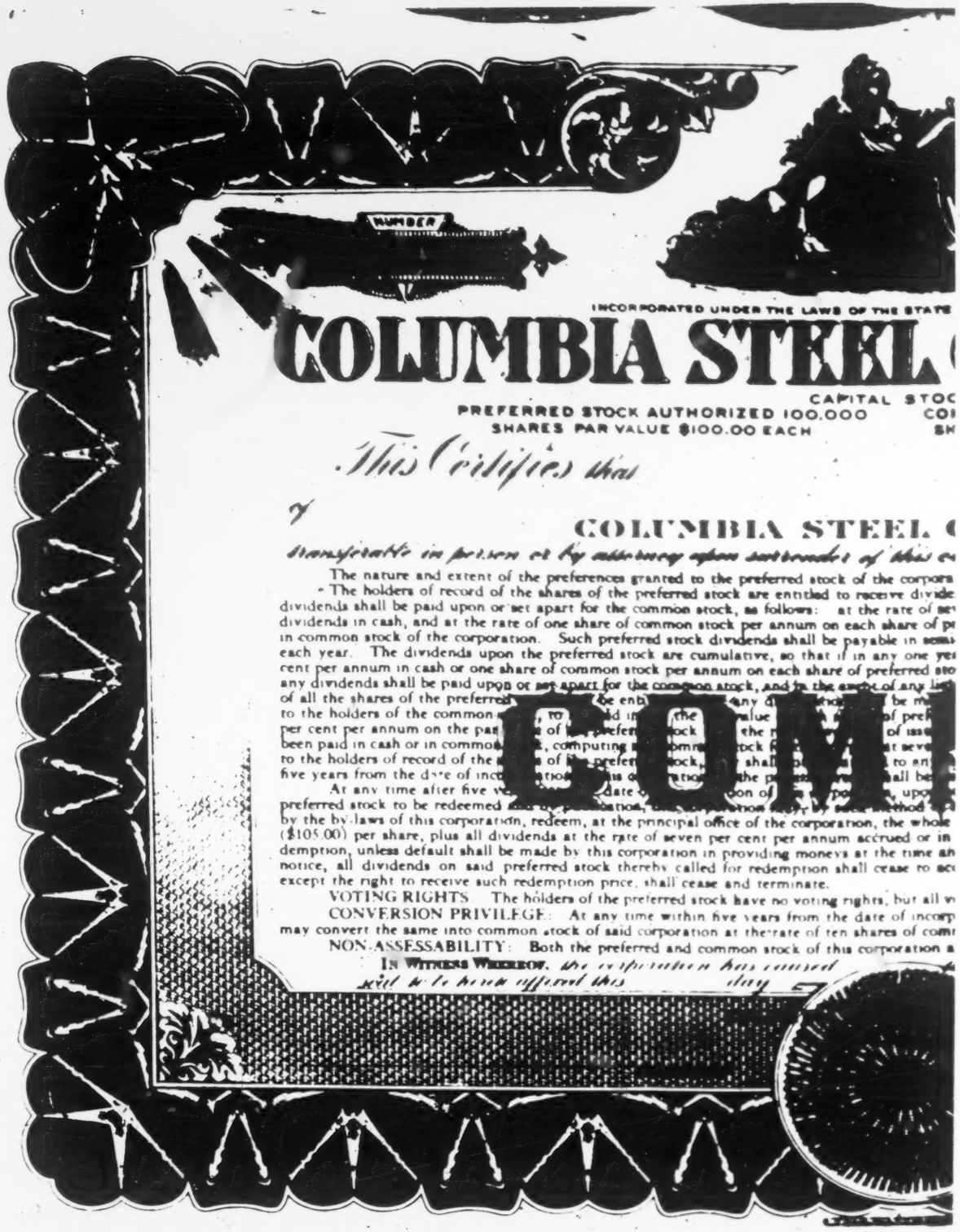
Dated 19

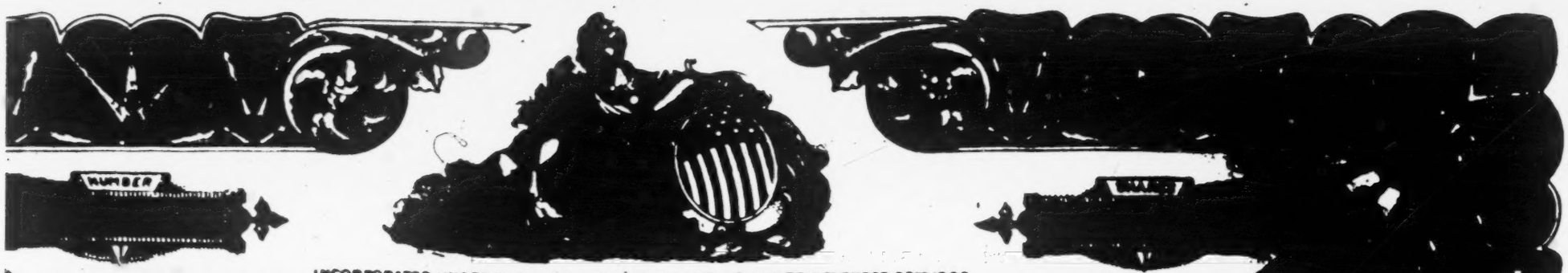
No. ORIGINAL CERTIFICATE	No. ORIGINAL SHARES	No. OF SHARES TRANSFERRED

Received CERTIFICATE No.

For Shares

this day of 19





INCORPORATED UNDER THE LAWS OF THE STATE OF DELAWARE, NOVEMBER 2ND 1922

COLUMBIA STEEL CORPORATION

CAPITAL STOCK

PREFERRED STOCK AUTHORIZED 100,000 SHARES PAR VALUE $100.00 EACH

COMMON STOCK AUTHORIZED 1,000,000 SHARES WITHOUT NOMINAL OR PAR VALUE

This Certifies that

is the owner

Shares of the Common Capital Stock of

COLUMBIA STEEL CORPORATION

transferable in person or by attorney upon surrender of this certificate duly endorsed

The nature and extent of the preferences granted to the preferred stock of the corporation are as follows:

The holders of record of the shares of the preferred stock are entitled to receive dividends from and after the respective dates of issuance of such shares before any vidends shall be paid upon or set apart for the common stock, as follows: at the rate of seven per cent per annum, if the board of directors shall determine to pay such vidends in cash, and at the rate of one share of common stock per annum on each share of preferred stock, if the board of directors shall determine to pay such dividends common stock of the corporation. Such preferred stock dividends shall be payable in semi-annual installments on the 1st day of January and on the 1st day of July in ch year. The dividends upon the preferred stock are cumulative, so that if in any one year dividends shall not have been paid thereon, either at the rate of seven per nt per annum in cash or one share of common stock per annum on each share of preferred stock, the deficiency shall be paid either in cash or in stock, as aforesaid, before y dividends shall be paid upon or set apart for the common stock, and in the event of any liquidation or dissolution or winding up of the corporation, the holders of record all the shares of the preferred [illegible] be entitled to receive out of the assets of the corporation available for distribution to stockholders, in preference to the holders of the common [illegible], to the amount of the par value of such preferred stock and also [illegible] and unpaid dividends from a sum equal to seven r cent per annum on the par value of such preferred stock for the number of years during which dividends have been paid on such shares, computing [illegible] dividends which shall have en paid in cash or in common stock for each year during which dividends have been paid in common stock; and after payment to the holders of record of the [illegible] of such preferred stock, [illegible] shall be entitled to any further participation in the distribution of assets of the corporation. No dividends accruing after e years from the date of incorporation of this corporation [illegible] the preferred stock shall be entitled to receive dividends in stock in preference to the holders of the common stock.

At any time after five years from the date of incorporation of this corporation, upon [illegible] days' notice by publication [illegible] to the record holders of the eferred stock to be redeemed at the office of the corporation, this corporation may, by such method as shall be provided from time to time by resolution of the board of directors or the by-laws of this corporation, redeem, at the principal office of the corporation, the whole or any part of the preferred stock at the rate of one hundred and five dollars 105.00) per share, plus all dividends at the rate of seven per cent per annum accrued or in arrears. From and after the date fixed in any such notice as the date of re-mption, unless default shall be made by this corporation in providing moneys at the time and place aforesaid for the payment of said redemption price, pursuant to such tice, all dividends on said preferred stock thereby called for redemption shall cease to accrue and the rights of the holders thereof as stockholders of this corporation, cept the right to receive such redemption price, shall cease and terminate.

VOTING RIGHTS: The holders of the preferred stock have no voting rights, but all voting rights are vested in the holders of the common stock.

CONVERSION PRIVILEGE: At any time within five years from the date of incorporation of this corporation, any of the holders of any of said preferred stock ay convert the same into common stock of said corporation at the rate of ten shares of common stock for each share of preferred stock converted.

NON-ASSESSABILITY: Both the preferred and common stock of this corporation are non-assessable.

IN WITNESS WHEREOF, the corporation has caused this certificate to be signed by its proper officers and its seal to be hereto affixed this day of

COMMON

For value Received, ... hereby sell, assign and transfer unto.....

..... Shares of the Capital Stock represented by the within Certificate, and do hereby irrevocably constitute and appoint ..... Attorney to transfer the said shares on the books of the within named Corporation, with full powers of substitution in the premises.

Dated ..... A. D. 19.....

.....

In Presence of

..... [71]

NOTICE: The signature to this assignment must strictly correspond with the name as written upon the face of the Certificate in every particular and without alteration or enlargement or any change whatever.

PREFERRED STOCK

CERTIFICATE

No. 7

for Shares

Issued to

Dated 19

FROM WHOM TRANSFERRED

Dated 19

No. ORIGINAL CERTIFICATE	No. ORIGINAL SHARES	No. OF SHARES TRANSFERRED

Received CERTIFICATE No.

for Shares

this day of 19

NUMBER

INCORPORATED UNDER THE LAWS OF THE STATE O

COLUMBIA STEEL C

CAPITAL STOCK

PREFERRED STOCK AUTHORIZED 100,000 COM

SHARES PAR VALUE $100.00 EACH SHA

This Certifies that

of

COLUMBIA STEEL C

transferable in person or by attorney upon surrender of this cer

The nature and extent of the preferences granted to the preferred stock of the corporatio

The holders of record of the shares of the preferred stock are entitled to receive dividend dividends shall be paid upon or set apart for the common stock, as follows at the rate of sever dividends in cash, and at the rate of one share of common stock per annum on each share of pref in common stock of the corporation. Such preferred stock dividends shall be payable in semi-a each year. The dividends upon the preferred stock are cumulative, so that if in any one year cent per annum in cash or one share of common stock per annum on each share of preferred stock any dividends shall be paid upon or set apart for the common stock, and in the event of any liquid of all the shares of the preferred stock shall be entitled, before any distribution shall be made to the holders of the common to be full alu ch per cent per annum on the par valu preferred st from the pective of issu been paid in cash or in comm to d stock thus pu at sever to the holders of record of th d st y sha be en o any five years from the date of i oration rporation on the ferred s shall be

At any time after five ars from d of incorporation of this corporation, upon preferred stock to be redeem and by p at th hority, by a by the by-laws of this corporation, redeem, at the principal office of the corporation, the whole or ($105.00) per share, plus all dividends at the rate of seven per cent per annum accrued or in ar demption, unless default shall be made by this corporation in providing moneys at the time and notice, all dividends on said preferred stock thereby called for redemption shall cease to accru except the right to receive such redemption price, shall cease and terminate.

VOTING RIGHTS: The holders of the preferred stock have no voting rights, but all voti

CONVERSION PRIVILEGE: At any time within five years from the date of incorpora may convert the same into common stock of said corporation at the rate of ten shares of commo

NON-ASSESSABILITY: Both the preferred and common stock of this corporation are

IN WITNESS WHEREOF, the corporation has caused the sail to be hereunto affixed this day

PREFE

NUMBER

SHARES

INCORPORATED UNDER THE LAWS OF THE STATE OF DELAWARE, NOVEMBER 22ND 1922

COLUMBIA STEEL CORPORATION

CAPITAL STOCK

PREFERRED STOCK AUTHORIZED 100,000 SHARES PAR VALUE $100.00 EACH

COMMON STOCK AUTHORIZED 1,000,000 SHARES WITHOUT NOMINAL OR PAR VALUE

This Certifies that

is the owner

of

Shares of the Preferred capital Stock of

COLUMBIA STEEL CORPORATION

transferable in person or by attorney upon surrender of this certificate duly endorsed

The nature and extent of the preferences granted to the preferred stock of the corporation are as follows:

The holders of record of the shares of the preferred stock are entitled to receive dividends from and after the respective dates of issuance of such shares before any dividends shall be paid upon or set apart for the common stock, as follows: at the rate of seven per cent per annum, if the board of directors shall determine to pay such dividends in cash, and at the rate of one share of common stock per annum on each share of preferred stock, if the board of directors shall determine to pay such dividends in common stock of the corporation. Such preferred stock dividends shall be payable in semi-annual installments on the 1st day of January and on the 1st day of July in each year. The dividends upon the preferred stock are cumulative, so that if in any one year dividends shall not have been paid thereon, either at the rate of seven per cent per annum in cash or one share of common stock per annum on each share of preferred stock, the deficiency shall be paid either in cash or in stock, as aforesaid, before any dividends shall be paid upon or set apart for the common stock, and in the event of any liquidation or dissolution or winding up of the corporation, the holders of record of all the shares of the preferred stock shall be entitled, before any distribution shall be made to the holders of the common stock and irrespective of the amount available to the holders of the common stock, to be paid in full [illegible] amount by way of, from a sum equal to seven per cent per annum on the par value of the preferred stock from the respective dates of issue to the date of distribution, the aggregate of such dividends which shall have been paid in cash or in common stock of this corporation on the preferred stock at seven per cent per annum, after payment of the amounts hereinabove specified to the holders of record of the preferred stock. No dividends accruing after five years from the date of incorporation shall be paid on the preferred stock, and no dividends shall be paid on the common stock.

PREFERRED

At any time after five years from the date of incorporation of this corporation, upon not less than thirty days' notice given by publication to the record holders of the preferred stock to be redeemed and by personal notice, if practicable, by mail, postage prepaid, to each such holder at his last known address, the corporation may, by action of the board of directors or by the by laws of this corporation, redeem, at the principal office of the corporation, the whole or any part of the preferred stock at the rate of one hundred and five dollars ($105.00) per share, plus all dividends at the rate of seven per cent per annum accrued or in arrears. From and after the date fixed in any such notice as the date of redemption, unless default shall be made by this corporation in providing moneys at the time and place aforesaid for the payment of said redemption price, pursuant to such notice, all dividends on said preferred stock thereby called for redemption shall cease to accrue and the rights of the holders thereof as stockholders of this corporation, except the right to receive such redemption price, shall cease and terminate.

VOTING RIGHTS: The holders of the preferred stock have no voting rights, but all voting rights are vested in the holders of the common stock.

CONVERSION PRIVILEGE: At any time within five years from the date of incorporation of this corporation, any of the holders of any of said preferred stock may convert the same into common stock of said corporation at the rate of ten shares of common stock for each share of preferred stock converted.

NON-ASSESSABILITY: Both the preferred and common stock of this corporation are non-assessable.

IN WITNESS WHEREOF, the corporation has caused this certificate to be signed by its proper officers and its seal to be hereunto affixed this day of

A.D.

1111
2222
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5555
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9999
0000

For value Received, ... hereby sell, assign and transfer unto.....

..... Shares of the Capital Stock represented by the within Certificate, and do hereby irrevocably constitute and appoint ..... Attorney to transfer the said shares on the books of the within named Corporation, with full powers of substitution in the premises.

Dated ..... A. D. 19.....

.....

In Presence of

..... [73]

NOTICE: The signature to this assignment must strictly correspond with the name as written upon the face of the Certificate in every particular and without alteration or enlargement or any change whatever.

PETITIONER'S EXHIBIT NO. 7

MINUTES OF SPECIAL MEETING OF THE BOARD OF DIRECTORS OF COLUMBIA STEEL CORPORATION, HELD JANUARY 29TH, 1923.

Pursuant to the call of the president and notice duly given, a special meeting of the board of directors of Columbia Steel Corporation was held at the office of the corporation at San Francisco, California, room 1205 of the Balfour Building, number 351 California Street, at two o'clock p. m. on Monday, the 29th day of January, 1923.

Present: Directors Alexander, Botchford, Boynton, Burrell, Creed, Dall, Drum, Grant, Rains and Sloss.

Absent: Directors Armstrong, Crocker, Ellis, Fleishhacker and Morse.

President Creed presided.

The secretary presented to the board the president's call for the meeting which was in the words and figures following:

"San Francisco, California,
January 22, 1923.

Mr. John D. Fenstermacher,
Secretary Columbia Steel Corporation,
San Francisco, California.

Dear Sir:

I hereby call a meeting of the board of directors of Columbia Steel Corporation, a corporation, to be held on Monday, January 29, 1923, at two o'clock p. m. at room 1205 of the Balfour Building, number 351 California Street, San Francisco, California.

Said meeting is called for the purpose of transacting such business as may come before the board, and particularly, for the purpose of having said board of directors consider and act upon the question of creating a bonded indebtedness of said Columbia Steel Corporation in the sum of ten million dollars, for the purpose of providing money to finance the contemplated development of the corporation and for other general corporate purposes.

You will please give the necessary notice of said meeting in accordance with the by-laws.

Yours very truly,

W. E. CREED,

President of Columbia Steel Corporation." [74]

On motion duly made, seconded and carried the call was ordered filed. The secretary then reported that notice of the meeting so called by the president had been given in accordance with the by-laws to each and every number of the board of directors by depositing in the United States Postoffice at San Francisco, California, on January 22, 1923, being more than three days before the time set for this meeting, a written notice with postage thereon fully prepaid, addressed to each director at the address last left with the secretary, which written notice is in the words and figures following:

"San Francisco, California,
January 22, 1923.

To the Members of the Board of Directors of
Columbia Steel Corporation:

Pursuant to the call of the president of Columbia Steel Corporation, a corporation, a meeting of the board of directors of said Corporation will be held on Monday, January 29th, 1923, at two o'clock p. m. at room 1205 of the Balfour Building, number 351 California Street, San Francisco, California.

Said meeting is called for the purpose of transacting such business as may come before the board, and particularly, for the purpose of having said board of directors consider and act

upon the question of creating a bonded indebtedness of said Columbia Steel Corporation in the sum of ten million dollars, for the purpose of providing money to finance the contemplated development of the corporation and for other general corporate purposes.

Yours very truly,
JOHN D. FENSTERMACHER
Secretary of Columbia Steel Corporation"

On motion duly made, seconded and carried, the notice of the meeting given by the secretary was duly approved.

The minutes of the directors' meeting held January 18, 1923, were read and on motion duly made and carried, were approved.

The president then announced that the meeting had been called for the purpose of having the board of directors consider and act upon the question of creating an original bonded indebtedness in the sum of ten million dollars for the purpose of providing money to finance the contemplated development of the corporation and for other general corporate purpose.

Thereupon, Director Sloss introduced the following resolution and moved its adoption: [75]

WHEREAS this corporation, Columbia Steel Corporation, owns or is about to acquire properties in the States of California, Utah and Oregon, which this corporation intends to develop and on which it contemplates the erection of a blast furnace and coke ovens, mills and other structures useful for its purposes, and

WHEREAS this corporation will require a large amount of money for the construction of said works, blast furnace, coke ovens, mills and other structures, and

WHEREAS there now exists no bonded indebtedness of this corporation and it is deemed now advisable to create a bonded indebtedness for the purpose of providing money for any and all legitimate and proper corporate purposes.

NOW, THEREFORE, BE IT RESOLVED that this corporation originally create a bonded indebtedness in a sum of not to exceed ten million dollars at any time outstanding represented by bonds to be designated as this corporation's First Mortgage Sinking Fund Gold Bonds, such bonds to be coupon bonds to be issued under the mortgage hereinafter referred to in any number of series and (with respect to each series) to bear such additional designation, to be of such denominations, to be issued and dated at such time or times, to bear such rate of interest, to mature at such time or times and to be subject to redemption and/or conversion on such terms as the board of directors of this corporation may determine as to each series thereof prior to or concurrently with the application of this corporation to the trustee named in the mortgage hereinafter referred to for authentication and delivery of the bonds proposed to be issued and sold, and of which the terms have

been so fixed; that all of such bonds shall be signed in the corporate name of this corporation by its president or one of its vice-presidents, shall be impressed with its corporate seal and shall be attested by its secretary, or an assistant secretary, and shall be certified by the trustee; that said coupon bonds, coupons, trustee's certificates and registration, are to be substantially in the form following respectively (proper insertions, omissions and variations to be made in respect to the form of bonds and coupons of each series in accordance with resolutions of the board of directors of this corporation, as hereinafter provided, to express all terms and conditions on which such bonds are issued as authorized and required by the mortgage hereinafter referred to).

FORM OF COUPON BOND

No. $.....

UNITED STATES OF AMERICA
STATE OF DELAWARE
COLUMBIA STEEL CORPORATION
FIRST MORTGAGE SINKING FUND
GOLD BONDS SERIES .....

.....per cent Due.....

Columbia Steel Corporation, a corporation organized and existing under the laws of the State of Delaware (hereinafter called the Corporation), for value *received, hereby* [76]

The motion for the adoption of said resolution was seconded by Director Grant and upon being put to a vote was unanimously carried.

Director Grant introduced the following resolution and moved its adoption:

> "WHEREAS W. E. Creed, as president of this corporation, heretofore entered into a contract in the name of this corporation, with Dillon, Read & Co., Anglo-London-Paris Company, Mercantile Securities Company, Anglo-California Trust Company and Union Trust Company of Cleveland, Ohio, for the sale to them of Series A of the bonds of this corporation this day authorized by this board of directors, said Series A to be entitled Fifteen Year First Mortgage 7% Sinking Fund Gold Bonds, Series A, and having an aggregate face value of $4,000,000.00, said sale having been at a price of 94½,
>
> NOW, THEREFORE, BE IT RESOLVED: That the action of said president in entering into said contract be, and the same is hereby, in all things fully approved, ratified and confirmed."

The motion for the adoption of said resolution was seconded by Director Rains and upon being put to a vote was unanimously carried.

Vice-President Grant was then called to the chair. Thereupon, W. E. Creed read and filed with the secretary a written offer in words and figures following:

"San Francisco, California,
January 29, 1923.

Columbia Steel Corporation,
San Francisco, California.

Gentlemen:

On December 15, 1922, you accepted my offer to transfer and convey to you certain properties described in my offer of the same date, in consideration, among other things, of your agreement to issue to me 39,918.42 shares of the preferred capital stock of your corporation and 535,000 shares of the common capital stock. Said common stock was to have been of the par value of $10.00 per share.

As it is contemplated that the common stock of your corporation will be changed from common stock having par value of $10.00 per share to common stock without nominal or par value, I offer to amend the contract between us by agreeing to transfer and convey to you the same properties described in my said offer of December 15, 1922, on the same terms therein mentioned, except that in addition to said 39,918.42 shares of your preferred stock to be issued to me, you are also to issue to me 547,500 shares of your common capital stock, without nominal or par value, in [77] lieu of said 535,000 shares of your common capital stock of a par value of $10.00 per share.

You may accept this offered modification conditional upon the approval by your stockholders

of the change in the par value of said common stock.

Yours truly,

W. E. CREED."

Director Alexander introduced the following resolution and moved its adoption:

"WHEREAS W. E. Creed has offered to modify his offer of December 15, 1922, which was accepted on said date by this corporation, by accepting 547,500 shares of the common capital stock of this corporation without nominal or par value in lieu of 535,000 shares of the common capital stock of this corporation of a par value of $10.00 per share.

WHEREAS this corporation desires so to change the common stock of this corporation from stock of a par value of $10.00 per share to stock without nominal or par value, and

WHEREAS this board of directors has determined, after careful investigation, that the assets so to be transferred and conveyed to this corporation, are a full, fair and adequate consideration for the issuance of 39,918.42 shares of the preferred capital stock of this corporation and 547,500 shares of its common capital stock without nominal or par value; both preferred and common stock to be issued as fully paid stock.

NOW, THEREFORE, BE IT RESOLVED that the offer of said W. E. Creed be and the same is hereby accepted, and the proper officers

of this corporation are hereby authorized and directed to issue to said W. E. Creed, or his nominees, 39,918.42 shares of the preferred capital stock of this corporation and 547,500 shares of the common capital stock of this corporation; both preferred and common stock to be issued as fully paid stock, upon receiving from W. E. Creed proper transfers and conveyances of the property described in said offer, provided that this acceptance is subject to permit or permits to be obtained for the issuance of such stock from the legal authorities having jurisdiction in the premises, and the president and secretary of this corporation are hereby authorized and directed to make application for such permit or permits at once, and this acceptance is further subject to the approval by the stockholders of this corporation of the change in the par value of the common stock of this corporation from stock having a par value of $10.00 per share to stock without nominal or par value."

The motion for the adoption of said resolution was seconded by Director Boynton and upon being put to a vote was carried by the following vote:

Ayes: Directors Alexander, Botchford, Boynton, Burrell, Dall, Drum, Grant, Rains and Sloss.

Noes: None.

Not voting: Director Creed. [78]

Thereupon, Director Creed resumed the chair.

Director Sloss introduced the following resolution and moved its adoption:

"RESOLVED that the action of the Executive Committee of this board of directors in having employed S. A. Kennedy as assistant to the president of this corporation and the contract of employment made with said S. A. Kennedy, be, and the same are hereby, fully approved, ratified and confirmed."

The motion for the adoption of said resolution was seconded by Director Boynton and upon being put to a vote was unanimously carried.

Director Dall introduced the following resolution and moved its adoption:

"RESOLVED that the president of this corporation, Columbia Steel Corporation, be and he is hereby authorized to sell for cash at par not more than $3,250,000, par value of the preferred capital stock of this corporation, to such persons as he shall determine; this authorization to include the $3,000,000.00 par value of said preferred stock authorized to be sold by this board of directors on December 15, 1922, and

FURTHER RESOLVED that the proper officers of this corporation are authorized and directed to apply for such permits from the legal authorities having jurisdiction in the premises as may be needed."

The motion for the adoption of said resolution was seconded by Director Sloss and upon being put to a vote was unanimously carried.

The meeting thereupon, on motion, adjourned.

JOHN D. FENSTERMACHER,

Secretary. [79]

The foregoing evidence is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the same is approved by the undersigned, Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, as attorney for the Commissioner of Internal Revenue.

(Signed) ROBERT H. JACKSON
Assistant General Counsel
for the
Bureau of Internal Revenue.

The foregoing is all of the material evidence adduced at the hearing and in order that the same may be preserved and made a part of the record, this statement of evidence is duly approved and settled this 4th day of December, 1934.

(Sgd) J. RUSSELL LEECH
Member, United States Board
of Tax Appeals. [80]

Service of a copy of the attached proposed statement of evidence presented by petitioner is hereby admitted, this 22nd day of October, 1934.

(s) JOHN C. ALTMAN,
Attorney for Respondent.

[Endorsed]: Lodged Nov. 9, 1934.
[Endorsed]: Filed Dec. 4, 1934. [81]

[Title of Court and Cause.]

PRAECIPE FOR RECORD.

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Ninth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of the proceedings before the Board.

2. Pleadings before the Board.

   (a) Petition, including annexed copy of deficiency letter.

   (b) Answer.

3. Findings of fact, opinion and decision of the Board.

4. Petition for review, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

5. Statement of the evidence as settled and allowed, including attached Exhibits Nos. 1 to 7 inclusive.

6. Orders enlarging time for the preparation of the evidence and for the transmission and delivery of the record.

7. This praecipe, together with proof of service of a copy of praecipe.

(Signed) ROBERT H. JACKSON,
Assistant General Counsel
for the
Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted this 22 day of October, 1934.

(Sgd) JOHN C. ALTMAN,
Attorney for Respondent.

[Endorsed]: Filed Nov. 9, 1934. [82]

[Title of Court and Cause.]

CERTIFICATE.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 82, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 18th day of December, 1934.

[Seal] B. D. GAMBLE,
Clerk,
United States Board of Tax Appeals.

[Endorsed]: No. 7224. United States Circuit Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Corinne S. Koshland, Respondent. Transcript of the Record. Upon Petition to Review an Order of the United States Board of Tax Appeals.

Filed December 24, 1934.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

No. 7724

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

CORRINE S. KOSHLAND,
Respondent.

Upon Petition to Review an Order of the United States Board of Tax Appeals.

PROCEEDINGS HAD IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

United States Circuit Court of Appeals for the Ninth Circuit.

Excerpt from proceedings of Friday, May 10, 1935.

Before: WILBUR, DENMAN and MATHEWS, Circuit Judges.

[Title of Cause.]

ORDER OF SUBMISSION

ORDERED above cause argued by Mr. John MacC. Hudson, Special Assistant to the Attorney General, counsel for the petitioner, and by Mr. John C. Altman, counsel for the respondent, and submitted to the court for consideration and decision.

United States Circuit Court of Appeals for the Ninth Circuit.

Excerpt from proceedings of Monday, January 20, 1936.

Before: WILBUR and GARRECHT, Circuit Judges.

[Title of Cause.]

ORDER DIRECTING FILING OF OPINION AND DISSENTING OPINION AND FILING AND RECORDING OF JUDGMENT.

By direction of the court, ORDERED that the opinion, and dissenting opinion this day rendered by this court in above cause be forthwith filed by

the clerk, and that a judgment be filed and recorded in the minutes of this court in accordance with the majority opinion rendered.

[Title of Court and Cause.]

OPINION.

Upon Petition to Review an Order of the United States Board of Tax Appeals.

Before: WILBUR, DENMAN and MATHEWS, Circuit Judges.

MATHEWS, Circuit Judge:

This is a petition brought by the Commissioner of Internal Revenue to review a decision of the Board of Tax Appeals holding that respondent's income tax liability for the year 1930 was $330.98 less than the Commissioner had determined it to be. The facts are as follows:

Respondent owned 165 shares of the preferred stock of Columbia Steel Corporation, some of which she purchased in 1924, and some in 1926. The total price paid by respondent for her stock was $14,996.11. The corporation's articles of incorporation provided that holders of its preferred stock should receive annually, as dividends thereon $7 per share in cash or, at the option of the corporation, one share of its common stock for each share of preferred. The articles further provided that dividends on the preferred stock should be paid in full before

any dividends should be paid or payable on the common. All voting rights pertained to the common stock, none to the preferred.

In each of the years 1925, 1926, 1927 and 1928 the corporation had a surplus sufficient to pay the preferred dividends in cash, but elected to pay them and did pay them in common stock, as authorized by its articles. Respondent received in those years an aggregate of 524½ shares of common stock as dividends on her preferred stock. In 1930 the corporation redeemed its preferred stock at $105 per share, respondent receiving for her 165 shares $17,325. In computing the profit realized by respondent, the Commissioner adjusted the cost basis of respondent's preferred stock by apportioning the $14,996.11 which she paid therefor between that stock and the common stock received by her as dividends thereon, in proportion to their respective values, thereby reducing the cost basis of respondent's preferred stock to $11,505.80. Thus computed, the profit realized by respondent was $5,819.20.

The Board of Tax Appeals held that the adjustment made by the Commissioner was improper; that the proper cost basis of respondent's preferred stock was the $14,996.11 which she paid therefor, and that, consequently, the profit realized therefrom was only $2,328.89. The effect of this holding is to reduce respondent's tax liability for the year 1930 to an amount $330.98 below that determined by the Commissioner. The Commissioner assigns this hold-

ing as error, and contends here, as he did below, that his adjustment of the cost basis of respondent's preferred stock was proper and should be upheld.

The propriety of this adjustment is determined by the character of the dividends paid in common stock of the corporation to holders of its preferred stock. It is conceded that if these dividends were taxable income, the adjustment was improper, and the Board's decision should be affirmed. It is also conceded, as it must be, that if these were stock dividends, they were not taxable income. In the Revenue Act of 1924, c. 234, §201(f), 43 Stat. 255, in the Revenue Act of 1926, c. 27, §201(f), 44 Stat. 11, and in the Revenue Act of 1928, c. 852, §115(f), 45 Stat. 822, it was provided that, "A stock dividend shall not be subject to tax." Thus the first question to be decided is whether the common stock received by respondent as dividends on her preferred stock did or did not constitute stock dividends.

Respondent admits that, when she received these dividends, she thought they were stock dividends, treated them as such, never reported them as income and never paid taxes on them, but she now says she was wrong in so thinking and so acting. She now contends that these were not stock dividends, because they were paid in common stock, whereas the stock on which they were paid was preferred stock. Whether this circumstance excludes them from the category of stock dividends is the question now to be considered.

In Thompson on Corporations, 3d Ed., Vol. 7, p.

137, § 5263, it is stated that "a stock dividend is what the term itself implies, a distribution of the stock of the corporation among the stockholders as a dividend." Other definitions are: "A dividend made payable by a corporation in new or unissued shares of its own stock" (14 C. J. 812); "one paid in stock, that is, not in money, but in a proportional number of shares of the capital stock of the company, which is ordinarily increased for this purpose to a corresponding extent" (Black's Law Dictionary, 2d Ed., p. 383). In none of these definitions is there any suggestion that, in order to constitute a stock dividend, the stock distributed and the stock already held must be of the same class.

The term "stock dividend" is not defined in the Revenue Acts, but the Treasury Regulations promulgated thereunder have uniformly treated it as embracing any stock issued by a corporation as a dividend to its stockholders, regardless of whether the stock so issued is or is not of the same class as the stock in respect of which it is issued. Regulations 65 and 69, Article 1548; Regulations 74, Article 628. This administrative interpretation is clearly correct. Even if doubtful, it should be upheld, unless unreasonable or inconsistent with the Acts. Fawcus Machine Co. v. United States, 282 U. S. 375, 378; Brewster v. Gage, 280 U. S. 327, 336; Maryland Casualty Co. v. United States, 251 U. S. 342, 349. It is neither unreasonable nor inconsistent, but is, we think, the only reasonable or consistent interpretation which could have been adopted.

The case of Eisner v. Macomber, 252 U. S. 189, cited by respondent, does not support her contention. The question in that case was whether a stock dividend paid in common stock of a corporation to holders of its common stock was income, within the meaning of the Sixteenth Amendment. The Supreme Court held that it was not, and that Congress, therefore, had no power to tax it as such. The question here presented is whether dividends paid in common stock of a corporation to a holder of its preferred stock were stock dividends, within the meaning of the Revenue Acts of 1924, 1926 and 1928. If so, they were exempt from taxation, whether they were income or not. The Eisner case dealt with an Act (Revenue Act of 1916, c. 463, § 2(a), 39 Stat. 757) which attempted, unconstitutionally, to tax all stock dividends. We are here dealing with Revenue Acts which expressly exempt all stock dividends from taxation. The question here is not what Congress could tax, but what it has taxed.

Respondent cites Commissioner v. Tillotson Mfg. Co. (C. C. A. 6), 76 F. (2d) 189, wherein it was held that a dividend paid in common stock of a corporation to holders of its preferred stock was not a stock dividend, within the meaning of the Revenue Act of 1926. We do not agree with that holding. It is based upon the erroneous assumption that, in exempting stock dividends from taxation, Congress intended only to exempt those which were already constitutionally exempt. There is no basis for any such assumption. Section 201(f) of the

Revenue Act of 1926 declares, without qualification, that a stock dividend shall not be subject to tax. The Tillotson decision, in effect, adds to this section the words, "provided such dividend is already constitutionally exempt from taxation." This proviso is not found in the Revenue Acts and should not be added thereto by judicial construction.

We hold that the term "stock dividend," as used in the Revenue Acts of 1924, 1926 and 1928, embraces all stock dividends, including those paid in common stock of a corporation to holders of its preferred stock. Whether such dividends constitute income, it is unnecessary to decide. If they are not income, they are exempt from taxation under the Sixteenth Amendment. If they are income, they are still exempt by express provisions of these Acts.

Respondent contends that, even though the common stock received by her constituted non-taxable stock dividends, it was nevertheless improper for the Commissioner to adjust the cost basis of her preferred stock by apportioning any part of it to the common stock so received. Her argument is that, under the Sixteenth Amendment, stock dividends of this particular type might have been taxed as income, and that, since they might have been so taxed, they could not be treated as other stock dividends are treated, namely, as merely constituting additional evidence of the stockholder's interest in the corporation.

Respondent's contention must be rejected. Assuming, without deciding, that Congress might consti-

tutionally have taxed stock dividends of this type, we hold that it was within the power of Congress to exempt such dividends from taxation and to treat them as other stock dividends are treated. That, we think, is what Congress did in the Revenue Acts of 1924, 1926 and 1928. In thereby exempting all stock dividends from taxation, Congress, in effect, declared that, for income tax purposes, such dividends, whether income or not, should be treated as merely constituting additional evidence of the stockholder's capital investment. If so treated when received, such dividends should be so treated, for the purpose of determining gain or loss, when a part of the capital investment is sold or otherwise disposed of.

These and other stock dividends were so treated in Treasury Regulations 74, which were in effect when respondent's preferred stock was redeemed and when her 1930 income tax return was filed. Article 58 of Regulations 74 provides:

> "* * * In the case of stock in respect of which any stock dividend was paid, the basis for determining gain or loss from a sale of a share of such stock shall be ascertained in accordance with the principles laid down in article 600.* * *"

Article 600 provides:

> "In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction [distribution of

stock on reorganization] described in section 112(g) and article 576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules:

"(1) Where the stock distributed in reorganization is all of substantially the same character or preference as the stock in respect of which the distribution is made, the basis of each share will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and new shares.

"(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class."

Article 628 of Regulations 74 provides:

> "The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which it is issued, shall be determined as provided in articles 561 and 600."

These Regulations were consistent with the Revenue Act of 1928, under which they were promulgated, and were, in our opinion, valid regulations. They were followed by the Commissioner in adjusting the cost basis of respondent's preferred stock. That adjustment was proper and should have been upheld.

Though not directly in point, the following cases have some bearing on the questions we have considered and are in accord with the views herein expressed: Miles v. Safe Deposit & Trust Co., 259 U. S. 247, 253; Beckers v. United States (Ct. Cl.), 42 F. (2d) 300, 301; Hewes v. Eaton (D. C., Conn.), 39 F. (2d) 917, 919; Ayer v Blair (App. D. C.), 25 F. (2d) 534, 535; Towne v. McElligott (D. C., S. D. N. Y.), 274 F. 960, 962.

The decision of the Board of Tax Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion.

DENMAN, Circuit Judge, Dissenting:

I dissent. The opinion of Judge Allen in Commissioner v. Tillotson Mfg. Co. (CCA 6th) 76 Fed. (2d) 189, sustaining the Board of Tax Appeals there, disposes of an analogous case. The same claim that Treasury Regulations supported the Commissioner's assessment was made in that case. I consider her conclusion, contrary to the prevailing opinion here, is correct. It is supported by the decisions of the Supreme Court in Weiss v. Stern, 265 U. S. 242, and Marr v U. S., 268 U. S. 536, discussed infra with regard to physical severance from capital in a corporate dividend, as necessary to constitute income. The decision of the Board of Tax Appeals here should be sustained.

I am unable to concur in the majority opinion that there is any question in this case "whether the common stock received by respondent as dividends on her preferred stock did or did not constitute stock dividends". It seems obvious that the distribution of a share of common stock to the holders of the preferred under provisions of the charter of this corporation constitutes a stock dividend. It is a dividend and it is stock.

Nor can I agree with the prevailing opinion that it is a matter of indifference whether the stock dividend in this case, if entirely different in character from the stock on which it was declared, is or is not income. If it is income from the original stock investment it is not a return of capital. The majority opinion's interpretation would have Congress at-

tempting to tax CAPITAL by the device of deducting from capital cost INCOME produced from capital in determining the gain on the sale of the stock representing the original investment. The constitutional amendment allowing the taxation of INCOME created no such right in Congress, and what we are here considering is an income tax.

To support such an attempt by Congress requires the implication that no stock dividend can be taxed even though essentially different in kind from the prior stock holding. A very wide field of income taxation would be removed from the Federal Government.

Hence I cannot concur in the majority's statement that in

> "exempting all stock dividends from taxation, Congress, in effect, declared that, for income tax purposes, such dividends, whether income or not, should be treated as merely constituting additional evidence of the stockholder's capital investment. If so treated when received, such dividends should be so treated, for the purpose of determining gain or loss, when a part of the capital investment is sold or otherwise disposed of."

Such treatment requires income to be treated as a return of capital. Nothing appears in the language of the taxing statute to warrant such an implied intent of Congress, nor is any implication permissible other than that, if the dividend stock is income, Congress intended to wait until it was

sold for its tax on such income. If this were not so patent, it is obvious that here there is at least an ambiguity and the construction most favorable to the taxpayer in determining the instant tax, claimed to be created by the legislation, should prevail. McFeely v. Commissioner, decided by the Supreme Court November 11, 1935. Furthermore, applying this rule of construction in favor of the instant taxpayer extends rather than contracts the Congressional area of taxation.

1. TAXPAYER'S COMMON STOCK DIVIDEND. ESSENTIALLY DIFFERENT FROM THE PREFERRED ON WHICH IT IS DECLARED, CONSTITUTES INCOME. WHEN ADDED TO THE PREFERRED, IT IS NOT A MERE SPLITTING OF SHARES SHOWING AN IDENTICAL INTEREST IN THE CORPORATE CAPITAL.

What the Commissioner seeks to tax is the taxpayer's gain from the sale of her preferred. He claims that the cost of the preferred should be apportioned between the preferred stock and the several common stock dividends received in years prior to the sale of the preferred. Obviously if the dividend on the preferred had been in cash or in other personal property, different in kind from the preferred, the apportionment should not be made.

The question is whether or not the common stock dividend issued on taxpayer's preferred stock interest is a mere splitting of the certificates of preferred

stock into a greater number of smaller units, so that the preferred and common aggregate a stock interest in the company substantially the same as before the dividend. If it is such a mere splitting of certificates, taxpayer has made no gain. She has received nothing but a changed evidence of her capital interest, and the cost of her preferred should be apportioned as claimed by the Commissioner.

If on the other hand the common stock is entirely different in character from the preferred and, when added to taxpayer's preferred holding, created an interest in the corporation entirely different from and more than that of her preferred before the dividend, then she has made a gain of something different from the preferred. That gain is just as much income to her as if it were in cash.

If it be argued that, while holding her preferred, taxpayer was holding the possible dividends in common stock and hence, when the common was distributed, she had no more than she had before, the answer is that in the same way she held the possible dividends in cash and hence a cash dividend would be but a return of capital. If such a fallacious argument be applied, the cash dividend would not be taxable as income but would merely reduce the purchase price of the preferred in determining a gain on its sale.

In this case taxpayer's common stock dividend differed from her preferred in two essential respects. (1) It represented an interest in the corpus of the corporate capital differing in kind and extent

from the preferred. (2) It carried with it voting rights, whereas the preferred stock had none. Further (3) the common dividends varied in amount in different issues, so that preferred holders of a later date of acquisition received a different proportion of voting power and different interest in the corporate capital from those of an earlier date. The radical difference between the preferred stock and the common stock is obvious from the inspection of that portion of the company's charter creating the stock. To use the language of Eisner v. Macomber, 252 U. S. 189, 208, "certainly the interest of the stockholder is a capital interest". The charter limited the preferred's interest in the capital to the par value of $100, and an accumulated unpaid 7% per annum thereon. The dividends on the preferred, at the option of the directors, are payable either in cash or a common stock theoretically representing a $7.00 interest in the corporate capital. The dividend common, after distribution, has its $7.00 nominal valuation reduced or increased as the company's capital rises or falls in value. The preferred does not change. On final liquidation of the corporation, the preferred comes first with its par and accumulated unpaid cash dividends. The issued common takes all the remaining reservoir of capital, whether diminished by loss or increased by profitable capital sales, profits of operation, or the increased value of capital assets.

In no sense can the kind of personal property received by the taxpayer in this common stock be

said to resemble the kind of property represented by her preferred stock. This is true whether we regard the stock as constituting an interest in the corpus of the company's capital or merely an expectancy of a participancy, definitely framed in the charter, in its capital assets. If expectancy is the correct description of the kind of property there is in common stock, the constant sales at large profits and losses of this expectancy in the great Stock Exchanges demonstrate it to be personal property of great value.

The preferred stock gave the taxpayer no participancy in the management of the corporation. All the voting rights were in the common stock. While it is true that to the average stockholder in great corporations this right of voting participancy in the management is infrequently exercised, in many cases it is of great value to the stockholder. Certainly considering the insistence of our courts on the significance of this right, when actually misused or thwarted in its exercise, it would be improper for us to hold the voting right a negligible factor in determining the character of personal property in stock.

The original issues of stock of the company were made at different dates and consisted in (1) no par common promotion stock without preferred; (2) blocks of 1 share preferred and 2 shares of common: (3) blocks of 1 share of preferred and 5 shares of common; (4) blocks of 1 share preferred and 50 shares of common.

At the time of each new issue of common the corporate surplus exceeded the aggregate of the debit to surplus, charged because of the issue.

The purchasers of blocks of common and preferred were not required to hold them in blocks or at all. The stock was sold on the stock market. Each holder of common, original or transferred, had his interest in the residue of the surplus value after the preferred interest and also his voting power changed by each issue of common thereafter.

Taxpayer purchased on February 28, 1924, 15 blocks of 1 share of preferred and 5 common. On this preferred she received a common dividend of 127 shares on January 31, 1925. This altered her prior common interest in the surplus and her voting power with a variable determined in part by the prior issue of common without preferred which received no dividend. On January 30, 1926, there was another common dividend affecting her prior held common with a similar variable. On March 22, 1926, she purchased 15 blocks of 1 preferred and 50 commen. This common altered her prior common interest in the surplus and her voting power with a similar variable There were two subsequent common dividends each of which affected her prior common holding by such a variable.

The above assumes that taxpayer held all her common through these transmutations of her interest. There is no evidence that she did. If, as she well could, she sold part of her common, then, on receiving the common dividend, the variable in her interest in the surplus capital contains different

factors. In any possible retention or disposition of the prior held common, the lack of identity of her stock interest before and after the stock dividend is demonstrable.

We thus see that in no sense could either Mrs. Koshland's voting power or interest in corporate capital be deemed the same after a common stock dividend was issued to her as it was before. The effect of the common dividend was to increase both her interest or expectancy in the company's capital and to change her voting power in its management.

With regard to a difference of stock character arising from her increased voting power, the case of Chapman v. U. S., 63 Ct. Cl. 105 (cert. den. 275 U. S. 524) is not an adverse decision. In that case the holder of common stock with a voting right received a dividend of common stock of exactly the same character but without the voting right. Since the common stock was identical in its interest or expectancy in the corporate capital and since, when received by the stockholder, he had exactly the same voting rights as before, it is plain that what he received was a mere dilution in share numbers of the same property. The situation is entirely different where one who has had no voting power in his preferred receives that valuable right through the common stock dividend. His position is changed with reference to his power to control the corporate management.

2. PHYSICAL SEVERANCE FROM THE CORPORATE CAPITAL NOT NECESSARY IN ORDER THAT A DIVIDEND CONSTITUTE INCOME. CONGRESS IS NOT DEPRIVED OF THE POWER TO TAX DIVIDEND STOCK, DIFFERING IN KIND FROM THE STOCK ON WHICH IT IS DECLARED, BY EISNER v. MACOMBER, 252 U. S. 189, AS CONSTRUED IN MARR v. U. S., 268 U. S. 536.

The fundamental question here is whether or not certain language of Eisner v. Macomber, suggesting that no stock dividend could be income because it detached nothing from the corpus of the company's property, must be projected beyond the facts presented in that case. Must it be deemed to apply to dividends of stock not identical with the stock on which the dividend is declared and which, under no theory, could be regarded as a mere splitting of stock certificates, leaving the stockholder with a personal property, identical in its value and character, with what he had before the dividend?

There were four Justices dissenting in Eisner v. Macomber and, while this does not change the binding character of the majority opinion, it suggests that the rule, particularly in constitutional cases, that a decision shall not be extended beyond the issues of fact upon which the adjudication rests, should be more certainly applied. As was said in Liverpool, New York and Philadelphia S. S. Company v. Commissioner of Emigration, 113 U. S. 33, 39:

"this court * * * has no jurisdiction to pronounce any statute either of the State or of the United States void * * * except as it is called upon to adjudge the legal rights of litigants in actual controversies. In the exercise of that jurisdiction, it is bound by two rules, to which it has rigidly adhered: one, never to anticipate a question of constitutional law in advance of the necessity of deciding it; the other, never to formulate a rule of constitutional law broader than is required by the precise facts to which it is to be applied. These rules are safe guides to sound judgment. It is the dictate of wisdom to follow them closely and carefully."

Chicago and Grand Trunk Ry. Co. v. Wellman, 143 U. S. 339, 345;
German Alliance Ins. Co. v. Home Water Supply Co., 226 U. S. 220, 234;
Howat v. Kansas, 258 U. S. 181, 184;
Taylor v. Voss, 271 U. S. 176, 184.

The ratio decidendi of Eisner v. Macomber, in my opinion, is expressed in the following excerpts from the opinion:

"The proportional interest of each shareholder remains the same. The only change is in the evidence which represents that interest, the new shares and the original shares together representing the same *proportional interest* that the original shares represented before the issue of the new ones. * * * What has

happened is that the plaintiff's old certificates have been split up in effect and have diminished in value to the extent of the value of the new. [italics ours]

* * * * * * *

"it does not alter the preexisting proportionate interest of any stockholder or increase the intrinsic value of his holding or of the aggregate holdings of the other stockholders as they stood before. The new certificates simply increase the number of the shares, with consequent dilution of the value of each share."

Eisner v. Macomber, 252 U. S. 189, 203, 211.

At another part of the opinion it is stated that the stockholder has no gain because

"there has been no segregation of profits, nor has he any separate certificate representing a personal gain, since the certificates, new and old, are *alike* in what they represent—a capital interest in the entire concerns of the corporation". [italics inserted]

It may be that the latter statement can be reasoned to apply only to certificates which are "ALIKE" in what they represent and not to certificates as unlike as those here in question.

If these words mean that the acquisition by the stockholder of an entirely different interest or expectancy in the corporate property cannot be regarded as income because none of the corporate property has been severed, it is submitted they are

but dicta. If the dicta be law, we repeat that Congress is without power to tax as income newly acquired personal property, different in character and incidents from the capital from which it is derived, truly regarded by the recipient as an addition to his income. If the criterion determining whether a stock dividend is income is that the recipient has received something detached from the corporate capital, then a gift by the corporation of its corporate stock is beyond the taxation of Congress. The recipient has received nothing from the corporation's assets that he did not have before and another area of taxation is shut off from the Congress.

As stated, the majority opinion in this case is in clear conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in Commissioner of Int. Rev. v. Tillotson Mfg. Co., 76 Feb. (2d) 189. Judge Allen's able opinion treats Eisner v. Macomber as requiring a double test for determining whether the stock dividend is income within the meaning of the Sixteenth Amendment to the Constitution. Her view is that a stock dividend is income unless the stock presents both (1) no severance of the corporate assets and (2) no identity of resultant interest or expectancy in the corporate property. The reasoning is that unless both tests are satisfied the stock dividend is income. In reaching the same result, I prefer to regard the language of Eisner v. Macomber with reference to the necessity for a severance of corporate property, if intended

as such a test of income, as dicta not conceived in the presence of the facts of this case.

This interpretation of Eisner v. Macomber is sustained by the subsequent decisions of the Supreme Court. In Weiss v. Stearn, 265 U. S. 242, the assets of the corporation were transferred to a new corporation and thereupon identical stock interests in the assets were created and the stock issued to the stockholders of the first corporation. The result of the transaction was that each stockholder had the same proportionate interest or expectancy in the corporate assets as he had before the transfer. The Supreme Court held that the transfer of the assets to a new corporation and the stock dividend declared by the new entity placed the stockholder in no different position than if a dividend of identical stock had come from the old corporation. There was no income to the holder of the new shares from the second corporation within the meaning of the Sixteenth Amendment.

In Marr v. U. S., 268 U. S. 536, 540, 541, 542, the assets were transferred to a new corporation of another state whose laws made the stock issued to the old stockholders of a different character from that held in the first corporation. This stock, because of its difference in character, was held to be income and the tax thereon was sustained by the decision. The difference between the Weiss case and the Marr case is not that the new corporation in the one case was incorporated in the same state and the other in a different state. If the second

charter in the Marr case had been so drawn that the stock distributed had given the distributee identical voting power and capital expectancy, the decision would have been the same in the latter case as in the Weiss case.

In the Marr case the Supreme Court distinguishes Eisner v. Macomber and Weiss v. Stearn in the following language:

> "In *Eisner v. Macomber* and in *Weiss v. Stearn,* where the additional value in new securities was held not to be taxable, the identity was deemed to have been preserved. In *Eisner v. Macomber* the identity was literally maintained. There was no new corporate entity. The same interest in the same corporation was represented after the distribution by more shares of precisely the same character. It was as if the par value of the stock had been reduced, and three shares of reduced par value stock had been issued in place of every two old shares. That is, there was an *exchange of certificates but not of interests.* In *Weiss v. Stearn* a new corporation had, in fact, been organized to take over the assets and business of the old. Technically there was a new entity; but the corporate identity was deemed to have been substantially maintained because the new corporation was organized under the laws of the same State, with presumably the same powers as the old. There was also no change in the character of securities issued. By reason of these facts, the

proportional interest of the stockholder after the distribution of the new securities was deemed to be exactly the same as if the par value of the stock in the old corporation had been reduced, and five shares of reduced par value stock had been issued in place of every two shares of the old stock. Thus, in *Weiss v. Stearn,* as in *Eisner v. Macomber,* the transaction was considered, in essence, an exchange of certificates representing the same interest, not an exchange of interests.

"In the case at bar, the new corporation is essentially different from the old. A corporation organized under the laws of Delaware does not have the same rights and powers as one organized under the laws of New Jersey. Because of these inherent differences in rights and powers, *both the preferred and the common stock of the old corporation is an essentially different thing from stock of the same general kind in the new.* But there are also adventitious differences, substantial in character. A 6 percent. non-voting preferred stock is an essentially different thing from a 7 percent. voting preferred stock. A common stock subject to the priority of $20,000,000 preferred and a $1,200,000 annual dividend charge is an essentially different thing from a common stock subject only to $15,000,000 preferred and a $1,050,000 annual dividend charge. The case at bar is not one in which after the distribution the stockholders have the same

> proportional interest of the same kind in essentially the same corporation." (italics inserted)
>
> Marr v. U. S., supra, 540, 541, 542.

The essence of the distinction between the Weiss and Marr cases is that in the latter the stockholder as a result of the stock dividend gets something more than a mere "exchange of certificates but not of interest". The stock is taxable because "both the preferred and common stock of the old corporation is an essentially different thing from the stock of the same general kind in the new". That is to say, with reference to the case at bar, the common stock with voting rights is something essentially different and new both as to capital expectancy and voting power from the preferred stock without voting rights.

That the decision of the court does not regard the language in Eisner v. Macomber relative to the necessity for a severance of the corporate assets from the corporation and their acquisition by the stockholders as controlling the question whether the stock dividend is income is even more clearly apparent from the dissent of four of the Justices. They support their contention that the new stock was not income in the following language:

> "The business and assets were not materially changed, and the stockholder received *nothing actually severed from his original* capital interest—nothing differing in *substance* from what he already had." (italics inserted)

The word "substance" is interpretable as applying to the dividend STOCK as differing in substance from what the stockholder already had, in which event the dissent would regard the common in this case as income because it differs from the preferred in the substance of its interest in the corporation. It is difficult to make such an interpretation, since the dividend stock in the Marr case also differed from the original stock in the interest created in the corporate assets. I regard the dissent as asserting that severance of corporate assets is necessary to create income, thus confirming my conviction that the majority holds severance unnecessary.

It is my opinion that the tax on the profit from the sale of Mrs. Koshland's preferred stock was properly determined by assigning none of its purchase price to her common stock dividend and that the decision of the Board of Tax Appeals should be sustained.

[Endorsed]: Opinion and Dissenting Opinion. Filed Jan. 20, 1936. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals for the Ninth Circuit.

No. 7724.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

CORRINNE S. KOSHLAND,
Respondent.

JUDGMENT

Upon Petition to Review an Order of the United States Board of Tax Appeals,

This cause came on to be heard on the Transcript of the Record from the United States Board of Tax Appeals

and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the Order of the said Board of Tax Appeals in this Cause be, and hereby is reversed, and the case is remanded for further proceedings consistent with the opinion of this court.

[Endorsed]: Filed and entered. January 20, 1936. Paul P. O'Brien, Clerk.

[Title of Court and Cause.]

ORDER STAYING ISSUANCE OF MANDATE

Upon application of Mr. John C. Altman, counsel for the respondent, and good cause therefor appearing, IT IS ORDERED that the issuance, under Rule 32, of the mandate of this Court in the above cause be, and hereby is stayed to and including March 2, 1936; and in the event the petition for a writ of certiorari to be made by the respondent herein be docketed in the Clerk's office of the Supreme Court of the United States on or before said date, then the mandate of this Court is to be stayed until after the said Supreme Court passes upon the said petition.

CURTIS D. WILBUR,
United States Circuit Judge.

Dated: San Francisco, California,
February 4, 1936.

[Title of Court and Cause.]

CERTIFICATE OF CLERK, U. S. CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT, TO RECORD CERTIFIED UNDER RULE 38 OF THE REVISED RULES OF THE SUPREME COURT OF THE UNITED STATES.

I, PAUL P. O'BRIEN, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing one hundred and thirty-five (135) pages, numbered from and including 1 to and including 135, to be a full, true and correct copy of the entire record of the above-entitled case in the said Circuit Court of Appeals, made pursuant to request of counsel for the respondent, and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

ATTEST my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 7th day of February, A. D. 1936.

[Seal] PAUL P. O'BRIEN,
Clerk.

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed March 30, 1936

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(7642-C)

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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1935

No. 774

CORINNE S. KOSHLAND,
Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals
for the Ninth Circuit.

JOHN C. ALTMAN,
Russ Building, San Francisco, California.
Attorney for Petitioner.

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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1935

No.

CORINNE S. KOSHLAND,
Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals
for the Ninth Circuit.

To the Honorable Charles Evans Hughes, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:

Petitioner Corinne S. Koshland prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Ninth Circuit entered in the above entitled cause on January 20, 1936.

OPINIONS BELOW.

The opinion of the Board of Tax Appeals (R. 25-32) is an unpublished Memorandum Opinion. The opinion of the Circuit Court of Appeals is reported in .....Fed. (2d)..... (R. 108-133.)

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on January 20, 1936. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

STATUTES INVOLVED.

The pertinent statutes involved will be found in the appendix, *infra*, page i.

QUESTION PRESENTED.

Where a dividend is declared upon cumulative non-voting preferred shares, payable in common voting shares, may the original cost of the preferred shares be reduced by apportioning such cost between the preferred and common shares for the purpose of determining gain or loss under the Revenue Act upon the sale or other disposition of the preferred shares?

STATEMENT OF THE CASE.

The facts as found by the Board of Tax Appeals in its Memorandum Opinion (R. 25-32) may be summarized as follows:

Petitioner acquired by purchase in 1924 and 1926 certain shares of preferred stock of Columbia Steel Corporation. The Articles of Incorporation of Columbia Steel Corporation provided that the holders of its preferred stock should receive annually as dividends thereon $7.00 per share in cash or, at the option of the corporation, one share of its common stock for each share of preferred stock. The Articles further provided that dividends on the preferred stock should be paid in full before any dividend should be paid or payable on the common stock. All voting rights pertained to the common stock, none to the preferred.

In each of the years 1925, 1926, 1927 and 1928 the corporation had a surplus sufficient to pay the preferred dividends in cash, but elected to pay them and did pay them in common stock, as authorized by its Articles. Petitioner received in those years shares of common stock as dividends on her preferred stock. In 1930 the corporation redeemed its preferred stock at $105.00 per share, pursuant to the provisions of the Articles. In computing the profit realized by petitioner, the Commissioner allocated to the common stock received, in each instance, a proportionate amount of the cost of the preferred stock upon which it was paid. This action of the Commissioner decreased the cost basis to petitioner of the preferred stock and increased the profit resulting from its redemption.

The Board of Tax Appeals disapproved the Commissioner's determination, holding that the proper cost basis of petitioner's preferred stock was the amount which she paid therefor.

The Circuit Court of Appeals reversed the decision of the Board of Tax Appeals and approved the Commissioner's determination.

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

1. In holding that a dividend declared upon cumulative non-voting preferred shares, payable in common voting shares, constituted a non-taxable stock dividend.

2. In holding that, for income tax purposes, dividends in the form of common stock paid upon preferred stock, whether income or not, should be treated as merely constituting additional evidence of the preferred stockholder's capital investment and that, for the purpose of determining gain or loss on the disposition of the preferred shares, the original cost of the preferred shares should be apportioned between the preferred stock and the common stock received as dividends thereon, in proportion to their respective values.

3. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT.

I.

THE DECISION BELOW IS IN DIRECT CONFLICT WITH THE DECISION OF ANOTHER CIRCUIT COURT OF APPEALS ON THE SAME MATTER.

The decision below is in direct conflict with *Commissioner v. Tillotson Mfg. Co.*, 76 Fed. (2d) 189 (C. C. A. 6). Both the majority and dissenting opinions in the decision below recognize such fact. The majority opinion in referring to *Commissioner v. Tillotson Mfg. Co.*, states: "We do not agree with that holding." (R. 112.) The dissenting opinion points out that "the majority opinion in this case is in clear conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in Commissioner of Int. Rev. v. Tillotson Mfg. Co. * * *." (R. 128.)

The decision below in the Ninth Circuit and the decision in *Commissioner v. Tillotson Mfg. Co.* in the Sixth Circuit are the only adjudications of the Circuit Courts upon the question involved herein. The issue presented in the *Tillotson* case was identical with that herein, viz., whether upon the sale or other disposition of shares of cumulative non-voting preferred stock upon which the holder had received a dividend payable in voting common stock, the original cost of the preferred shares should be reduced, for income tax purposes, by apportioning such cost between the preferred and common shares.

II.

THE DECISION BELOW IS IN CONFLICT WITH APPLICABLE DECISIONS OF THIS COURT.

The decision below is inconsistent with the holdings of this Court in *Eisner v. Macomber,* 252 U. S. 189, *Weiss v. Stearn,* 265 U. S. 242, and *Marr v. United States,* 268 U. S. 536. In those cases this Court held that Congress under the Sixteenth Amendment cannot tax as income that which is not in fact income. In the *Eisner* case a dividend paid in stock was held not to be income and hence not taxable where the dividend is of such character that "the proportional interest of each shareholder remains the same" and the "only change is in the evidence which represents that interest, the new shares and the original shares together representing the same proportional interest that the original shares represented before the issue of the new ones". In the *Weiss* case a dividend in the form of stock was held taxable as income where the stockholder receives "a thing really different from what he heretofore had". In the *Marr* case this Court declared, in respect of a distribution claimed by the taxpayer to be a tax free stock dividend, that "the additional value of the new securities * * * is income", where "the stockholders no longer owned merely the same proportional interest of the same character in the same corporation". The majority opinion in the Court below held that it is immaterial whether the common stock received by petitioner as dividends on her preferred stock constituted income at time of receipt; that "such dividends, whether income or not, should be treated

as merely constituting additional evidence of the stockholder's capital investment"; and that for the purpose of determining gain or loss upon the sale of the preferred shares, the cost thereof should be reduced by reason of the receipt of the dividend in common shares. (R. 114.) As pointed out in the dissenting opinion in the Court below, the "majority opinion's interpretation would have Congress attempting to tax *capital* by the device of deducting from capital cost *income* produced from capital in determining the gain on the sale of the stock representing the original investment". (R. 117-118.) In thus holding that *capital* may be taxed as income, the decision of the Court below is in direct conflict with the principle enunciated by this Court in *Eisner v. Macomber, Weiss v. Stearn* and *Marr v. United States,* supra.

III.

THE CASE PRESENTS AN IMPORTANT QUESTION OF FEDERAL LAW.

The question presented is important, because (a) of the recognized frequency of dividends of the character here involved; (b) of the large number of cases now pending before the Board of Tax Appeals presenting the identical issue; (c) the applicable provisions of the Revenue Acts of 1926 and 1928 involved herein have been carried forward, unchanged, into the Revenue Acts of 1932 and 1934.

Wherefore, it is respectfully submitted that this petition should be granted.

Dated, San Francisco, California,
February 17, 1936.

JOHN C. ALTMAN,
Attorney for Petitioner.

(Appendix Follows.)

Appendix

REVENUE ACT OF 1926.

Distributions by corporations.

"Sec. 201 (a). The term 'dividend' * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913."

44 Stat. 10.

"Sec. 201 (f). A stock dividend shall not be subject to tax."

44 Stat. 11.

Note: Section 115, subdivisions (a) and (f) of the Revenue Act of 1928 are identical.

45 Stat. 822.

REVENUE ACT OF 1928.

Determination of amount of gain or loss.

"Sec. 111 (a). * * * the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in Section 113 * * *."

45 Stat. 815.

Basis for determining gain or loss.

"Sec. 113 (a). The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that * * *" (The exceptions have no application and are therefore omitted.)

45 Stat. 818.

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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1935

No. 774

CORINNE S. KOSHLAND,
Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR PETITIONER.

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On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR PETITIONER.

OPINIONS BELOW.

The opinion of the Board of Tax Appeals (R. 25-32) is an unpublished Memorandum Opinion. The opinion of the Circuit Court of Appeals (R. 108-133) is reported in 81 Fed. (2d) 641.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered January 20, 1936. (R. 134.) Petition for certiorari was filed February 25, 1936, and was granted March 30, 1936. The jurisdiction of this Court rests upon Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

Where a dividend is declared upon cumulative non-voting preferred shares, payable in common voting shares, may the original cost of the preferred shares be reduced by apportioning such cost between the preferred and common shares for the purpose of determining gain or loss under the Revenue Act upon the sale or other disposition of the preferred shares?

STATUTES AND REGULATIONS INVOLVED.

The pertinent statutes and regulations involved will be found in the Appendix, *infra*.

STATEMENT.

The undisputed facts may be summarized as follows:

Petitioner acquired by purchase in 1924 and 1926 certain shares of preferred stock of Columbia Steel Corporation. (R. 26, 27, 42.) The Articles of Incorporation of Columbia Steel Corporation provided that

the holders of its preferred stock should receive annually as dividends thereon $7.00 per share in cash or, at the option of the corporation, one share of its common stock for each share of preferred stock. The Articles further provided that dividends on the preferred stock should be paid in full before any dividend should be paid or payable on the common stock. All voting rights pertained to the common stock, none to the preferred. (R. 26, 89.) The preferred stock was redeemable by the corporation at the sum of $105.00 per share, plus all accrued dividends. Upon any dissolution or liquidation of the company, the preferred stock was entitled to a preferential payment of $100.00 per share, plus all accrued dividends, and no more. The common stock was solely entitled, upon dissolution or liquidation, to all the residual assets of the corporation then remaining. (R. 89.)

In each of the years, 1925, 1926, 1927 and 1928, the corporation had a surplus sufficient to pay the preferred dividends in cash, but exercised its election to pay them in common stock, as authorized by its Articles. Petitioner received in those years shares of common stock as dividends on her preferred stock. In 1930 the corporation redeemed its preferred stock at $105.00 per share. (R. 26, 27, 59.) In computing the profit realized by petitioner, the Commissioner allocated to the common stock received, in each instance, a proportionate amount of the cost of the preferred stock upon which it was paid. This action of the Commissioner decreased the cost basis to petitioner of the preferred stock and increased the profit resulting from its redemption. (R. 28.)

The Board of Tax Appeals disapproved the Commissioner's determination and held that the dividends received in common stock did not constitute stock dividends representing the mere dilution of the stockholders' present interests but were taxable dividends which did not serve to reduce the cost basis of the preferred stock upon which they were paid. (R. 30-31.)

The Circuit Court of Appeals reversed the decision of the Board of Tax Appeals and approved the Commissioner's determination. (R. 134.)

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

1. In holding that a dividend declared upon cumulative non-voting preferred shares, payable in common voting shares, constituted a non-taxable stock dividend.

2. In holding that, for income tax purposes, dividends in the form of common stock paid upon preferred stock, whether income or not, should be treated as merely constituting additional evidence of the preferred stockholder's capital investment and that, for the purpose of determining gain or loss on the disposition of the preferred shares, the original cost of the preferred shares should be apportioned between the preferred stock and the common stock received as dividends thereon, in proportion to their respective values.

3. In reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT.

I.

The test to be applied in determining whether a dividend paid by a corporation in the form of its own stock is or is not income, is whether, after the distribution, the stockholders have the same proportional interest of the same kind as they formerly possessed. If the dividend amounts to a mere splitting of the certificates formerly held by each stockholder into a greater number of smaller units, the stockholder receives no income through the dividend. If, on the other hand, the stock received as a dividend is entirely different in character from that originally held and, when added to the stockholder's original holding, creates an interest in the corporation entirely different from and in addition to that of his original holding, income results from the receipt of the dividend. The dividend in the form of comon voting shares which petitioner received upon her cumulative non-voting preferred stock resulted in an increase in her interest in the corporation. Consequently, such dividend constituted income to her at time of receipt.

II.

A. The Revenue Acts in effect at the times when petitioner received the dividends in the form of shares of common stock provided that: "A stock dividend shall not be subject to tax". Congress, in so exempting stock dividends from tax was referring only to such dividends as did not constitute income. It did not exempt dividends of the type received by petitioner.

B. Even assuming that Congress exempted from taxation dividends of the type received by petitioner, it does not follow that, for the purpose of determining gain or loss upon the subsequent disposition of petitioner's preferred shares, the cost thereof should be reduced by reason of the prior receipt of the dividend in common shares. The mere exemption from taxation by Congress of an otherwise taxable dividend cannot, upon a subsequent sale, affect the cost basis of the shares of stock in respect of which the dividend was paid, unless Congress shall have made appropriate provision for the adjustment of such cost basis. Since no such appropriate provision appears in the applicable Revenue Act, it was improper to reduce the cost of petitioner's preferred stock by assigning a portion thereof to the common stock received as a dividend thereon.

ARGUMENT.

PRELIMINARY STATEMENT.

The Commissioner, in computing the profit realized by petitioner on the disposition of shares of cumulative non-voting preferred stock, apportioned the cost thereof between those shares and shares of common voting stock received as dividends thereon. If the receipt of the common voting shares did not constitute income to petitioner, it is conceded that the action of the Commissioner was correct. On the other hand, if, as petitioner contends, the receipt of the common stock did constitute income to her, then the adjustment by

the Commissioner of the cost of the preferred stock was improper, regardless of whether or not Congress exempted the dividends from taxation at time of receipt. This conclusion follows, because "cost" is the only basis prescribed in the Revenue Act for determining the gain to petitioner on the disposition of her preferred stock, and no provision is contained in the Act authorizing the Commissioner to deduct, from the cost of such stock, the income produced therefrom.

I.

THE DIVIDENDS IN THE FORM OF COMMON STOCK CONSTITUTED INCOME TO PETITIONER WHEN RECEIVED.

In order to determine whether the dividends declared by Columbia Steel Corporation upon its cumulative non-voting preferred shares, payable in its common voting shares, constituted income to the preferred shareholders, it is essential that certain facts with respect to the capital structure of the corporation be kept in mind. At all material times, Columbia Steel Corporation had outstanding shares of preferred stock of a par value of $100.00 per share and shares of common stock, without par value. The preferred shares of the corporation were entitled to cumulative preferential dividends at the rate of 7% per annum, which, under the charter of the corporation, could be and were paid during the first five years of the existence of the company, in common stock of the corporation, at the rate of one share of common stock per annum for each share of preferred stock outstand-

ing. The preferred stock had no voting rights, all voting rights being vested in the shares of common stock. The preferred stock was redeemable by the corporation at the sum of $105.00 per share, plus all accrued dividends. Upon any dissolution or liquidation of the company, the preferred stockholders were entitled to a preferential payment of $100.00 per share, plus all accrued dividends, after which the preferred stockholders had no further participation in any residual assets of the corporation.

In *Eisner v. Macomber,* 252 U. S. 189, this Court was called upon to consider whether a 50% dividend declared by a corporation upon its stock, payable in the form of additional shares of precisely the same character, constituted income to the recipient. The Collector of Internal Revenue assessed an income tax against Macomber on that part of the value of the stock dividend which represented surplus earned by the corporation between March 1, 1913, and the date of the payment of the dividend. As the basis of his exaction, the Collector relied upon Section (2) (a) of the Revenue Act of 1916, 39 Stat. 757, which provided that a "stock dividend shall be considered income, to the amount of its cash value". Macomber contended that the stock dividend which she received did not constitute income to her and that consequently Congress had no power under the Sixteenth Amendment to impose a tax upon her by reason of the receipt of such dividend. This Court sustained the contention of Macomber, stating at page 219 that:

> "The Revenue Act of 1916, in so far as it imposes a tax upon the stockholder because of such

dividend, contravenes the provisions of Article 1, §2, cl. 3, and Article 1, §9, cl. 4, of the Constitution and to this extent is invalid notwithstanding the 16th Amendment."

In arriving at the conclusion that the dividend in question did not constitute income to the taxpayer, this Court was apparently influenced by two factors, namely: (1) there was no severance of the corporate assets, and hence no income received by the distributee and (2) the dividend did not alter the pre-existing proportionate interest of any stockholder or increase the intrinsic value of his holding or the aggregate holdings of the other stockholders as they stood before.

It is difficult to determine from a reading of *Eisner v. Macomber* alone, which point this Court regarded as vital. Any uncertainty, however, as to the true basis for the decision in *Eisner v. Macomber* has been effectually dispelled by the later decision of this Court in *Marr v. United States*, 268 U. S. 536. The facts in that case were as follows: The taxpayer had purchased certain shares of 7% preferred stock and certain shares of common stock in General Motors Company of New Jersey. The voting privileges attached to both classes of shares. Subsequently, the corporation having accumulated a large surplus, a new corporation was formed under the laws of Delaware known as General Motors Corporation of Delaware, which offered to issue to stockholders of the New Jersey corporation five shares of its common stock for each share of common stock of the New Jersey corporation, and 1½ shares of its 6% non-voting preferred stock for each share of preferred stock of the

New Jersey corporation. All of the common stock of the New Jersey corporation was exchanged on this basis as was all but a few shares of preferred, which were redeemed in cash. Having become the owner of all of the stock of the New Jersey corporation, the Delaware corporation caused the assets of the New Jersey corporation to be transferred to it, subject to the liabilities of the transferor corporation. Thereupon the New Jersey corporation was dissolved. The taxpayer exchanged all of his stock in the manner outlined.

The Government contended that the difference between the cost of the stock of the New Jersey corporation and the value of the stock in the Delaware corporation which the taxpayer received in exchange, constituted taxable income to him. The taxpayer on the other hand, contended that such difference could not constitutionally be taxed under the rule of *Eisner v. Macomber,* supra.

This Court, in sustaining the contention of the Government, stated, at page 539:

> "Marr contends that, since the new corporation was organized to take over the assets and continue the business of the old, and his capital remained invested in the same business enterprise, the additional securities distributed were in legal effect a stock dividend; and that, under the rule of Eisner v. Macomber, 252 U. S. 189, 64 L. ed. 521, 9 A. L. R. 1570, 40 Sup. Ct. Rep. 189; applied in Weiss v. Stearn, 265 U. S. 242, 68 L. ed. 1001, 33 A. L. R. 520, 44 Sup. Ct. Rep. 490, he was not taxable thereon as income, because he still held the whole investment. The

government insists that identity of the business enterprise is not conclusive; that gain in value resulting from profits is taxable as income, not only when it is represented by an interest in a different business enterprise or property, but also when it is represented by an essentially different interest in the same business enterprise or property; that, in the case at bar, the gain actually made is represented by securities with essentially different characteristics in an essentially different corporation; and that, consequently, the additional value of the new securities, although they are still held by the Marrs, is income under the rule applied in United States v. Phellis, 257 U. S. 156, 66 L. ed. 180, 42 Sup. Ct. Rep. 63; Rockefeller v. United States, 257 U. S. 176, 66 L. ed. 186, 42 Sup. Ct. Rep. 68; and Cullinan v. Walker, 262 U. S. 134, 67 L. ed. 906, 43 Sup. Ct. Rep. 495. In our opinion the government is right.

In each of the five cases named, as in the case at bar, the business enterprise actually conducted remained exactly the same. In United States v. Phellis, in Rockefeller v. United States, and in Cullinan v. Walker, where the additional value in new securities distributed was held to be taxable as income, there had been changes of corporate identity. That is, the corporate property, or a part thereof, was no longer held and operated by the same corporation; and, after the distribution, the stockholders no longer owned merely the same proportional interest of the same character in the same corporation. In Eisner v. Macomber, and in Weiss v. Stearn, where the additional value in new securities was held not to be taxable, the identity was deemed to

have been preserved. In Eisner v. Macomber the identity was literally maintained. There was no new corporate entity. The same interest in the same corporation was represented after the distribution by more shares of precisely the same character. It was as if the par value of the stock had been reduced, and three shares of reduced par value stock had been issued in place of every two old shares. That is, there was an exchange of certificates, but not of interests. In Weiss v. Stearn, a new corporation had, in fact, been organized to take over the assets and business of the old. Technically there was a new entity; but the corporate identity was deemed to have been substantially maintained because the new corporation was organized under the laws of the same state, with presumably the same powers as the old. There was also no change in the character of securities issued. By reason of these facts, the proportional interest of the stockholder after the distribution of the new securities was deemed to be exactly the same as if the par value of the stock in the old corporation had been reduced, and five shares of reduced par value stock had been issued in place of every two shares of the old stock. Thus, in Weiss v. Stearn, as in Eisner v. Macomber, the transaction was considered, in essence, an exchange of certificates representing the same interest, not an exchange of interests.

In the case at bar, the new corporation is essentially different from the old. A corporation organized under the laws of Delaware does not have the same rights and powers as one organized under the laws of New Jersey. Because of these inherent differences in rights and powers,

both the preferred and the common stock of the old corporation is an essentially different thing from stock of the same general kind in the new. But there are also adventitious differences, substantial in character. A 6 per cent, non-voting, preferred stock is an essentially different thing from a 7 per cent, voting, preferred stock. A common stock subject to the priority of $20,000,000.00 preferred and a $1,200,000.00 annual dividend charge is an essentially different thing from a common stock subject only to $15,000,000.00 preferred and a $1,050,000.00 annual dividend charge. The case at bar is not one in which, after the distribution, the stockholders have the same proportional interest of the same kind in essentially the same corporation."

It is significant that this Court, in *Marr v. United States* regarded *Eisner v. Macomber,* supra, as controlling, and considered the exchange of securities by the taxpayer in legal effect the same as a dividend. It is also significant that this Court in *Marr v. United States* recognized, as was pointed out in the dissenting opinion in that case, that "the stockholder received nothing actually severed from his original capital interest." The sole basis therefore for the decision that the additional value of the new securities received by the taxpayer constituted income, was that the stockholders after the distribution did not "have the same proportional interest of the same kind in essentially the same corporation."

It is clear, therefore, that the true test, as laid down by this Court in *Eisner v. Macomber* and clarified by *Marr v. United States,* to be applied in de-

termining whether a dividend in the form of stock is or is not income, is not whether the taxpayer receives assets which have been severed from the corporation, but whether after the distribution, the stockholders have the same proportional interest of the same kind as they formerly possessed. If the dividend distributed to stockholders in the form of additional shares of stock amounts to a mere splitting of the certificates formerly held by each stockholder into a greater number of smaller units, so that the old and new shares aggregate a stock interest in the company substantially the same as he held before the dividend, the stockholder receives no income through the dividend. If, on the other hand, the stock received as a dividend is entirely different in character from the stock originally held by the stockholder, and when added to the stockholder's original holding, creates an interest in the corporation entirely different from and in addition to that of his original holding, income results from the receipt of the dividend.

In *Commissioner of Internal Revenue v. Tillotson Manufacturing Company*, 76 Fed. (2d) 189, the Circuit Court of Appeals for the Sixth Circuit, held that a dividend of the same character as that involved in the case at bar, namely, a dividend on cumulative non-voting preferred shares, payable in common voting shares of the same corporation, was income to the recipient. The Court in that case analyzed the decision of this Court in *Eisner v. Macomber*, supra, and stated:

"The Commissioner urges that under the decisions of the Supreme Court of the United States, and particularly Eisner, Collector, v. Macomber, 252 U. S. 189, this particular distribution of common stock is not subject to tax, and that the Board of Tax Appeals erred in its order and decision. In that case, common stock was distributed pro rata to common stockholders. The decision that the dividend was not subject to tax was based partly upon the proposition that there was no severance of the corporate assets, and hence no income received by the distributee. However, it was also pointed out in that case, as a material fact, that the dividend did not alter the pre-existing proportionate interest of any stockholder or increase the intrinsic value of his holding or of the aggregate holdings of the other stockholders as they stood before.

Two tests were thus established for distinguishing a taxable from a non-taxable dividend in stock: (1) Severance of assets from the corporation, and (2) alteration of the pre-existing proportionate interest of the stockholders.

In the instant case the first test was met. There was no severance of corporate assets. The distribution was made to its preferred shareholders by the corporation, not in stock of another corporation, not from its own treasury stock, but from its own unissued stock.

The second test was not met. The pre-existing proportionate interest of the stockholders was substantially altered.

* * * * * * *

United States v. Phellis, 257 U. S. 156, presented the case of a reorganization resulting in

the formation of a company not substantially identical with the first. The court, holding that a dividend in stock of the old company paid in stock of the new company was taxable as individual income, stressed the fact that the individual stockholders of the old company 'received assets of exchangeable and actual value severed from their capital interest in the old company, proceeding from it as the result of a division of former corporate profits, and drawn by them severally for their individual and separate use and benefit'.

The court also stated that the liability of a stockholder to pay an individual income tax must be decided by the effect of the transaction upon the individual.

Weiss, Collector, v. Stearn, 265 U. S. 242, held that a dividend in stock was non-taxable upon the ground that it constituted an issuance and exchange of certificates representing the same pre-existing interest. The court again declared that to constitute gain 'separated from the original capital interest', the stockholder must receive 'a thing really different from what he theretofore had'.

In Marr v. United States, 268 U. S. 536, the distribution of stock was held to constitute taxable income. The court grounded its decision upon the fact that after the distribution the stockholders no longer owned 'the same proportional interest of the same kind in essentially the same corporation'.

It is true that there is a distinction between the instant case and those cited. Here the dividend issued to the preferred stockholders in

payment of the accrued preferred dividends was unissued stock of the corporation itself, not stock in any other corporation. However, the right to share in assets upon dissolution, and in the earnings of the corporation upon the declaration of dividends, was materially altered. Each preferred stockholder, in consideration of relinquishing his rights to the accrued preferred dividends, secured new voting rights, and additional property rights which might well afford him a different and greater market with an increased money return. In fact the precise situation was presented, described under different circumstances, in United States v. Phellis, supra, that the preferred stockholders received assets of an exchangeable and actual value proceeding from their capital interest in the old company, drawn by them for their individual and separate use and benefit.

We think that the mere circumstance that this transformation was effected within one single organization does not alter the applicability of these rules. The Commissioner erred in applying to the transaction one test only of those laid down in Eisner, Collector, v. Macomber, supra, and the other decisions above cited. Applying the other test, namely, that of alteration of proportionate interests, the preferred stockholders received taxable income, and respondent did not err in the computation of its taxable gain.

The decision of the Board of Tax Appeals is affirmed."

The majority opinion in the Court below gave no consideration to the question whether the dividends

received by petitioner were or were not in fact income, holding that:

> "The question here is not what Congress could tax, but what it has taxed * * * Whether such dividends constitute income it is unnecessary to decide. If they are not income, they are exempt from taxation under the Sixteenth Amendment. If they are income, they are still exempt by the express provisions of these Acts. * * * Assuming, without deciding, that Congress might constitutionally have taxed stock dividends of this type, we hold that it was within the power of Congress to exempt such dividends from taxation and to treat them as other stock dividends are treated. * * * such dividends, whether income or not, should be treated as merely constituting additional evidence of the stockholder's capital investment."
>
> (R. 112-114.)

The dissenting opinion in the instant case held that the dividends received by petitioner definitely constituted income, stating:

> "The fundamental question here is whether or not certain language of Eisner v. Macomber, suggesting that no stock dividend could be income because it detached nothing from the corpus of the company's property, must be projected beyond the facts presented in that case. Must it be deemed to apply to dividends of stock not identical with the stock on which the dividend is declared and which, under no theory, could be regarded as a mere splitting of stock certificates, leaving the stockholder with a personal prop-

erty, identical in its value and character, with what he had before the dividend? * * *

The ratio decidendi of Eisner v. Macomber, in my opinion, is expressed in the following excerpts from the opinion:

'The proportional interest of each shareholder remains the same. The only change is in the evidence which represents that interest, the new shares and the original shares together representing the same *proportional interest* that the original shares represented before the issue of the new ones. * * * What has happened is that the plaintiff's old certificates have been split up in effect and have diminished in value to the extent of the value of the new.

* * * * * * *

It does not alter the pre-existing proportionate interest of any stockholder or increase the intrinsic value of his holding or of the aggregate holdings of the other stockholders as they stood before. The new certificates simply increase the number of the shares, with consequent dilution of the value of each share.'

* * * * * * *

This interpretation of Eisner v. Macomber is sustained by the subsequent decision of the Supreme Court. In Weiss v. Stearn, 265 U. S. 242, the assets of the corporation were transferred to a new corporation and thereupon identical stock interests in the assets were created and the stock issued to the stockholders of the first corporation. The result of the transaction was that each stockholder had the same proportionate interest or expectancy in the corporate assets as he had before the transfer. The Supreme Court held that the

transfer of the assets to a new corporation and the stock dividend declared by the new entity placed the stockholder in no different position than if a dividend of identical stock had come from the old corporation. There was no income to the holder of the new shares from the second corporation within the meaning of the Sixteenth Amendment.

In Marr v. U. S., 268 U. S. 536, 540, 541, 542, the assets were transferred to a new corporation of another state whose laws made the stock issued to the old stockholders of a different character from that held in the first corporation. This stock, because of its difference in character, was held to be income and the tax thereon was sustained by the decision. The difference between the Weiss case and the Marr case is not that the new corporation in the one case was incorporated in the same state and the other in a different state. If the second charter in the Marr case had been so drawn that the stock distributed had given the distributee identical voting power and capital expectancy, the decision would have been the same in the latter case as in the Weiss case.

* * * * * * *

The essence of the distinction between the Weiss and Marr cases is that in the latter the stockholder as a result of the stock dividend gets something more than a mere 'exchange of certificates but not of interest'. The stock is taxable because 'both the preferred and common stock of the old corporation is an essentially different thing from the stock of the same general kind in the new'. That is to say, with reference to the case at bar, the common stock with voting rights is something

essentially different and new both as to capital expectancy and voting power from the preferred stock without voting rights."

(R. 125-132.)

If, as we believe is established by the decisions of this Court, a dividend paid in the form of stock of the issuing corporation is income to the recipient whenever, through the dividend, the pre-existing proportionate interests of the stockholders are substantially altered, it is apparent that the dividend paid on the preferred shares in the form of common shares of Columbia Steel Corporation constituted income to the preferred stockholders. Before the dividend declared by Columbia Steel Corporation, the preferred stockholders had solely a limited participation in the assets, which was fixed in amount and extent. All that the preferred stockholders were entitled to receive by virtue of their holdings was (a) preferential payment of cumulative dividends in a specified amount, and (b) a preferential right to receive $100.00 per share, plus accrued dividends, and no more, upon dissolution or liquidation, any residual value of the assets being distributable ratably to the common stockholders, or (c) payment of $105.00 per share, plus accrued dividends in case of redemption. When petitioner received the shares of common stock as a dividend upon the preferred shares, her former interest was increased, because petitioner and all other preferred stockholders owned additionally a proportional interest in the residual assets of Columbia Steel Corporation remaining over and above the preferential pay-

ment to the preferred stockholders. The common stock thus received could have been sold, and after any such sale the preferred stockholders would, aside from the proceeds of sale, still have maintained their identical original financial position in the corporation. Manifestly, this situation is far different from that where a common stockholder receives, by way of a stock dividend, additional shares of common stock, as a result of which his proportional interest in the corporate property still remains identical, and he has two pieces of paper in lieu of one, but with no greater interest in the corporate assets.

It thus follows that the dividends received by petitioner in the form of common stock constituted income to her which Congress could have taxed under the authority vested in it by the Sixteenth Amendment to the Constitution.

II.

SINCE THE DIVIDENDS IN THE FORM OF COMMON STOCK CONSTITUTED INCOME TO PETITIONER WHEN RECEIVED, THEY CANNOT PROPERLY BE TREATED AS REDUCING THE COST TO PETITIONER OF HER PREFERRED STOCK.

(A) Congress Did Not Exempt Such Dividends From Taxation When Received.

Congress in the Revenue Acts of 1916, 1917 and 1918 attempted to tax stock dividends as income by providing that "a stock dividend shall be considered income, to the extent of its cash value". Such attempt was held to be unconstitutional in *Eisner v. Macomber*, supra (decided in 1920), because, as heretofore pointed out, a dividend in stock which in no way changes the

proportional interests of the shareholders is not income.

In the Revenue Act of 1921, after the decision in *Eisner v. Macomber,* Congress excluded stock dividends from taxation in Section 201(d) of that Act,[1] providing:

> "A stock dividend shall not be subject to tax."
> (42 Stat. 228.)

Petitioner contends that the dividends in the form of common stock of Columbia Steel Corporation which she received upon her preferred stock were not "stock dividends" within the meaning of the above-quoted provisions of the Revenue Acts.

The term "stock dividend" was first defined and limited by this Court in *Gibbons v. Mahon,* 136 U. S. 549, the Court stating at page 559:

> "A stock dividend really takes nothing from the property of the corporation, and adds nothing to the interests of the shareholders. Its property is not diminished and their interests are not increased. After such a dividend, as before, the corporation has the title in all the corporate property; the aggregate interests therein of all the shareholders are represented by the whole number of shares, and the proportional interest of each shareholder remains the same. The only change is in the evidence which represents that interest, the new shares and the original shares together representing the same proportional interest that the original shares represented before the issue of new ones."

1. Section 201(f) of the 1926 Act and Section 115(f) of the 1928 Act are exact counterparts of Section 201(d) of the 1921 Act.

While no question of taxation was involved in *Gibbons v. Mahon*, the foregoing definition of a stock dividend has subsequently received the approval of this Court in *Eisner v. Macomber*, supra, and other tax cases.

The reason for the enactment of Section 201(d) of the 1921 Act is to be found in House Report No. 350, 67th Congress, 1st Session, page 8:

> "Section 202 modifies the definition of dividends in existing law by exempting stock dividends from the income tax, as required by the decision of the Supreme Court in Eisner v. Macomber. (252 U. S. 189.)"

Similar language is contained in Senate Report No. 275, 67th Congress, 1st Session, page 9. It is therefore an established fact that Congress in the Revenue Act of 1921 was exempting "stock dividends" from taxation solely because such action was "required by the decision of the Supreme Court in Eisner v. Macomber". This being so, it seems apparent that Congress was exempting only the type of dividends which possessed the characteristics referred to in *Gibbons v. Mahon* and *Eisner v. Macomber*.

As aptly stated by the Board of Tax Appeals in *Tillotson Manufacturing Co. v. Commissioner*, 27 B. T. A. 913, 918:

> "When it is realized that the occasion for the original prototype of Section 201(f), namely, Section 201(d) of the Revenue Act of 1921, exempting stock dividends from tax, was the decision of the Supreme Court in Eisner v. Macomber, supra, annulling so much of Section

> 2(a) of the Revenue Act of 1916 as included stock dividends among those taxable, it becomes clear that the subsequent statutory exemption was only as broad as the decision, and hence that the intention was not to exempt stock dividends by any general or loose concept, but only such as could not constitutionally be taxed because they were not income. The term 'stock dividend' is not of itself so free from ambiguity as to preclude construction, and hence the statutory exemption must be construed to promote the intendment disclosed by the history and circumstances of its enactment. This requires that it be confined to such as have the attributes which distinguished them from the receipt of income by the shareholder. Only those which place the shareholder in no essentially different position are exempt."

We fully realize that definitions may be found in dictionaries and textbooks to the effect that a "stock dividend" is "a distribution of the stock of the corporation among the stockholders as a dividend". (*Thompson on Corporations,* 3d ed. Vol. 7, page 137, Sec. 5263.) Under such a definition any distribution by a corporation to its stockholders of its own stock could be regarded as "a stock dividend". However, the definition of the term which Congress had in mind when it drafted the Revenue Act of 1921 was not any loose general definition, but rather the definition of the term as first stated by this Court in *Gibbons v. Mahon,* supra, and approved in *Eisner v. Macomber.*

The statutory provision with respect to stock dividends creates an exemption from taxation. Any construction therefore which would extend such exemp-

tion to transactions not clearly within the contemplation of the statutory provision should be rejected. (*Bank of Commerce v. Tennessee,* 161 U. S. 134, 146.)

(B) Assuming That Congress Exempted Such Dividends From Taxation When Received, no Authority Exists in the Revenue Act for Reducing the Cost of the Preferred Stock by Assigning Any Portion of its Original Cost to the Common Stock.

If, as we contend, Congress did not exempt from taxation dividends paid on preferred stock in the form of common stock, it necessarily follows that the judgment of the Court below must be reversed. The majority opinion concedes that if our premise be correct, the conclusion drawn follows as a matter of course. (R. 110.)

However, even if we assume that Congress did exempt from taxation, at the time of receipt, dividends of the character here involved, it by no means follows that, for the purpose of determining gain or loss under the Revenue Act upon the disposition of the preferred shares, the original cost of the preferred shares may be reduced by apportioning such cost between the preferred and common shares.

The redemption of the preferred stock held by petitioner occurred in the year 1930. The determination of gain or loss to petitioner upon such redemption is therefore governed by the Revenue Act of 1928. Section 111(a) of that Act provides:

> "the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in Section 113 * * *."
>
> (45 Stat. 815.)

Section 113 provides that:

> "The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that * * *."[2]
>
> (45 Stat. 818.)

As pointed out by the Court of Appeals of the District of Columbia in respect of the exceptions to the ordinary rule of cost prescribed by Section 204 of the Revenue Act of 1926, 44 Stat. 14 (Section 204 of the 1926 Act being a counterpart of Section 113 of the Revenue Act of 1928):

> "The purpose of these provisions was to make applicable an exception to the ordinary basis for determining gain or loss, i. e., cost to taxpayer * * *."
>
> *Elmore Milling Co. v. Helvering*, 70 Fed. (2d) 736.

None of the exceptions can possibly have any application to the instant case. We thus have a situation where petitioner has disposed of certain shares of preferred stock owned by her and where

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2. The exceptions are twelve in number, contained in separate subdivisions of Section 113, and have reference to:
Property which should have been included in the last inventory. (Subdiv. 1.)
Property acquired by gift or transfer in trust after December 31, 1920. (Subdivs. 2 and 3.)
Property acquired by a gift or transfer in trust before January 1, 1921. (Subdiv. 4.)
Property transmitted at death. (Subdiv. 5.)
Property acquired in connection with specified statutory tax-free exchanges of property. (Subdiv. 6.)
Property acquired by a corporation in connection with a reorganization where the control remains in specified persons. (Subdivs. 7 and 8.)
Securities received by way of distribution upon reorganization without the surrender of the original securities held. (Subdiv. 9.)
Property acquired as a result of a compulsory or involuntary conversion. (Subdiv. 10.)
Stock or securities acquired by "wash sales". (Subdiv. 11.)
Property acquired by a corporation during affiliation. (Subdiv. 12.)

the only statutory provision with respect to the method for determining her gain or loss upon such disposition requires that the basis for such determination "shall be the cost of such property".

Notwithstanding the absence of any statutory authority for adjusting the cost basis to petitioner of her shares of preferred stock, the Commissioner, for the purpose of determining the gain to petitioner upon the redemption of the shares of preferred stock, has apportioned the cost between the preferred and common stock in proportion to their respective values. As the sole support for his action in so apportioning cost, the Commissioner relies upon Article 628 of Regulations 74. Article 628, in so far as material, provides that the issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but the amount of gain derived or loss sustained from the sale of the stock in respect of which the dividend is issued shall be determined as provided in Article 600.

Article 600 was promulgated solely to carry into effect the provisions of Section 113 (o) of the Revenue Act of 1928.[3] That article, in so far as material, provides that where a shareholder receives distribution of stock in connection with a transaction described in

3. Section 113 (9) provides that if a stockholder receives stock or securities which have been distributed to him in connection with a transaction described in Section 112 (g) of the same Act, and thereafter disposes of the stock in respect of which the distribution was made, the basis for determining the gain or loss from the disposition of such stock "shall be apportioned under rules and regulations prescribed by the Commissioner with the approval of the Secretary" between such stock and the stock distributed. The sole transaction described in Section 112 (g) is the distribution to a stockholder, in pursuance of a plan of reorganization, of stock or securities in the same corporation or another corporation a party to the reorganization, without the surrender of the stock upon which the distribution was made; and the Section provides that no gain to the distributee from the receipt of such stock or securities shall be recognized.

Section 112(g) of the Revenue Act of 1928, 45 Stat. 818, and thereafter sells the original shares upon which such distribution was received, the gain or loss on the shares sold should be computed by apportioning the cost of the shares originally held between those shares and the shares acquired by distribution, in proportion to the respective value of each stock.

In *Manhattan General Equipment Company v. Commissioner*, 80 L. ed. Adv. Ops. 380 (decided Feb. 3, 1936), this Court had under consideration Section 204(a) (9) of the Revenue Act of 1926, and amended Article 1599 of Regulations 69, which were respectively exact counterparts of Section 113 (9) of the Revenue Act of 1928 and Article 600 of Regulations 74. That case involved the determination of the amount of loss to the taxpayer on the disposition of shares of stock originally held upon which there had been a distribution of the type described in Section 112(g) of the Revenue Act of 1928. As originally promulgated, Article 1599 of Regulations 69 contained a proviso limiting the cost attributable to the shares received by way of distribution to the market value of such shares at date of receipt, but in all other respects Article 1599 of Regulations 69 was identical with Article 600 of Regulations 74. At a later date Article 1599 was amended by the Commissioner so as to delete therefrom the proviso just referred to. The taxpayer sold certain shares of stock between the date of the promulgation of the original Article and the amended Article. The sole question involved before this Court was whether the loss of taxpayer was to be determined in accordance with the original or amended regulation. This Court held that the loss must be

determined under the amended regulation, because the original regulation was not only unreasonable, but inconsistent with the statute authorizing the promulgation thereof. In the course of his opinion, Mr. Justice Sutherland stated, at page 382:

> "The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity. Lynch v. Tilden Co., 265 U. S. 315, 320-322; Miller v. United States, 294 U. S. 435, 439-440, and cases cited. And not only must a regulation in order to be valid, be consistent with the statute, but it must be reasonable. International Ry. Co. v. Davidson, 257 U. S. 506, 514. The original regulation as applied to a situation like that under review is both inconsistent with the statute and unreasonable.
>
> The contention that the new regulation is retroactive is without merit. Since the original regulation could not be applied, the amended regulation in effect became the primary and controlling rule in respect of the situation presented. It pointed the way, for the first time, for correctly applying the antecedent statute to a situation which arose under the statute. See Titsworth v. Com'r of Int. Rev., 73 F. (2d) 385, 386. The statute defines the rights of the taxpayer and fixes a standard by which such rights are to be measured. The regulation constitutes only a step in the administrative process. It does not and could not, alter

> the statute. It is no more retroactive in its operation than is a judicial determination construing and applying a statute to a case in hand."

Similarly, in *Morrill v. Jones*, 106 U. S. 466, it was held:

> "The Secretary of the Treasury cannot, by his Regulations, alter or amend a Revenue Act."

It is thus established by the decision of this Court in the *Manhattan* case, supra, that Article 600 of Regulations 74 derives its validity solely by reason of the fact that it carries into effect the provisions of Section 113(9) of the Revenue Act of 1928. As heretofore indicated, Section 113(9) applies exclusively to the particular type of transaction described therein, viz., the receipt of stock or securities, by way of distribution, in connection with a plan of reorganization, without the surrender of the stock in respect of which the distribution was made. The instant dividend does not classify as a transaction within the purview of Section 113(9). There is no other provision of the Revenue Act of 1928 authorizing the Commissioner to make any apportionment of cost. If the Commissioner, where expressly authorized by statute to apportion cost in a particular designated transaction may not prescribe a manner and method of apportionment which is inconsistent with the statute granting such right, *a fortiori* the Commissioner may not make any apportionment in respect of an entirely different transaction, where the statute gives him no such authority.

It therefore follows that the Commissioner may not rely upon Article 628 of Regulation 74 in support of his apportionment of the cost of petitioner's preferred stock between that stock and the common stock.

Where a stockholder has received, as a dividend, stock of precisely the same character as his original stock so that no income has resulted from the receipt of the dividend, it is entirely proper upon the subsequent disposition of the original stock to apportion the cost thereof between the original stock and the dividend stock. No statutory authorization exists in any of the Revenue Acts for such apportionment nor is any needed, because the apportionment of the cost of the original stock is in no sense an artificial "adjustment" of cost. In such case, the cost per share of the original stock is obviously not the quotient of the purchase price divided by the total number of shares originally purchased. "The old shares have proliferated, as it were, and although the right they represented has now suffered a cellular division into smaller units of greater number, that is all that has happened". (*Towne v. McElligott*, 274 Fed. 960.) After the receipt of such a stock dividend, the stockholder's proportional capital interest in the corporation is precisely the same as it was prior to the receipt of the dividend, but that interest is now evidenced by an additional number of shares. Consequently, in order to determine the actual cost per share of the original stock, it becomes necessary to give consideration to the fact that the stockholder's original holding is now represented by an additional number of shares of the same class and character—and hence to divide

the purchase price by the total number of old and new shares in order to ascertain the cost of each share. The spreading of the purchase price of stock over both that originally purchased and that of like kind received as a dividend thereon, is merely a process which is necessarily required in order to determine the actual and not the fictitious cost of the original stock.

On the other hand, where there is not a mere split-up of shares but on the contrary, the issuance, as a dividend of shares of a totally different class and character from the shares upon which the dividend was declared, and which give to the recipient for the first time an interest in the residual assets of the corporation, the new shares constitute income to the stockholder. After the receipt of the dividend, the stockholder has an additional and different interest in the corporation over and above that already held. In such case the cost per share of the original stock is totally unaffected by the receipt of the additional shares of stock distributed as a dividend thereon and no adjustment of the cost of the original stock can be made in the absence of Congressional authorization.

The original cost of the preferred shares which petitioner purchased is not in dispute. The shares of common stock which petitioner received as dividends thereon were income to petitioner and in no way affected the cost of petitioner's preferred stock. Since Congress has not seen fit to provide for any adjustment of the cost of the preferred stock, it follows that, regardless of whether or not Congress exempted the dividends from taxation when received, the action of

the Commissioner in apportioning the cost of the preferred stock between that stock and the dividend stock was improper.

CONCLUSION.

For the foregoing reasons, the decision of the Circuit Court of Appeals is erroneous and should be reversed.

Dated, San Francisco, California,
April 15, 1936.

Respectfully submitted,
JOHN C. ALTMAN,
Attorney for Petitioner.

WILLARD L. ELLIS,
Of Counsel.

(Appendix Follows.)

Appendix

Revenue Act of 1926.

Distributions by Corporations.

"Sec. 201(a). The term 'dividend' * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913."

"Sec. 201(f). A stock dividend shall not be subject to tax."

44 Stat. 10-11.

Note: Section 115, subdivisions (a) and (f) of the Revenue Act of 1928 are identical. 45 Stat. 822.

Revenue Act of 1928.

Determination of Amount of Gain or Loss.

"Sec. 111(a). * * * the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in Section 113 * * *."

45 Stat. 815.

Recognition of Gain or Loss.

"Sec. 112(a). General rule—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section. * * *

(g) Distribution of stock on reorganization.—If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities

in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized."

45 Stat. 818.

Basis for Determining Gain or Loss.

"Sec. 113(a). Property acquired after February 28, 1913.—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that * * *.

(9) Tax-Free Distributions.—If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in section 112(g), the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed; * * *"

45 Stat. 818.

Regulations 74.

"*Art. 600.* Stock or securities distributed in reorganization.—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 112 (g) and article 576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares

shall be determined in accordance with the following rules:

(1) Where the stock distributed in reorganization is all of substantially the same character or preference as the stock in respect of which the distribution is made, the basis of each share will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class."

"*Art. 628.* Stock dividends.—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which it is issued, shall be determined as provided in articles 561 and 600."

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No. 774

In the Supreme Court of the United States

OCTOBER TERM, 1935

CORINNE S. KOSHLAND, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

In the Supreme Court of the United States

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We do not oppose the granting of a writ of certiorari in this case.

The court below held that common stock distributed by a corporation to the taxpayer as a dividend on her preferred stock is a non-taxable stock dividend within the meaning of Section 115 (f) of the Revenue Act of 1928, so that the original cost of the preferred shares is reduced by apportioning such cost between the preferred and common shares for the purpose of determining the gain upon the subsequent disposition of the preferred shares. This decision conflicts with the

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decision of the Circuit Court of Appeals for the Sixth Circuit in *Commissioner* v. *Tillotson Mfg. Co.*, 76 F. (2d) 189, wherein it was held that common stock distributed as a dividend on preferred stock is a taxable dividend, and that consequently no justification exists for adjusting the cost basis of the preferred stock. While we think the decision of the court below, which is in conformity with existing Treasury practice, is right, in view of the conflict and because it is important in the administration of the revenues that the question be settled, we do not oppose the granting of the writ.

Respectfully submitted.

STANLEY REED,
Solicitor General.

MARCH 1936.

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BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 25–32) is not reported. The opinion of the Circuit Court of Appeals for the Ninth Circuit (R. 108–133) is reported in 81 F. (2d) 641.

JURISDICTION

The judgment of the Circuit Court of Appeals reversing the Board of Tax Appeals was entered January 20, 1936. (R. 134.) Petition for writ of

certiorari was filed February 25, 1936, and was granted March 30, 1936. (R. 137.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether common stock distributed by a corporation to the petitioner as a dividend upon preferred stock is a nontaxable dividend, so that the original cost of the preferred stock is reduced by apportioning such cost between the preferred and common shares for the purpose of determining the gain upon the petitioner's subsequent disposition of the preferred shares, or a property dividend subject to taxation.

2. Whether the petitioner, having failed to report common stock received as a dividend upon preferred stock as a property dividend for income tax purposes in the years of receipt, is estopped to assert in a later year that such was a taxable dividend with no effect upon the cost of such preferred stock.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 39–42.

STATEMENT

The essential facts as stipulated (R. 59) and found by the Board of Tax Appeals (R. 25–29) are as follows:

The petitioner, a resident of San Francisco, California (R. 25), was a stockholder in the Columbia Steel Corporation (R. 26, 27), a Delaware corporation organized in November, 1922, with authorized capitalization of 100,000 shares of preferred stock of a par value of $100 per share, and 1,000,000 shares of common stock, originally of $10 par value each but by charter amendment of no par value (R. 25, 59, 61, 63).

At the time of its organization the corporation acquired from W. E. Creed certain property in exchange for 39,918.42 shares of its preferred stock and 547,500 shares of its common stock, to be issued to W. E. Creed or his nominees. (R. 25, 44, 45, 97–99.) The remaining preferred stock of the corporation was offered to the public at par (R. 26, 100), and Creed offered to certain prospective purchasers of the preferred stock five shares of his common stock for each share of preferred purchased from the corporation (R. 26). No common stock was sold by the corporation. (R. 45.) Petitioner, under this offer, subscribed for 150 shares of preferred stock at par, and in 1924 paid therefor $15,000 (R. 42, 43–44), with the understanding that she also would receive 750 shares of common stock (R. 26, 45). The 750 shares of common stock were issued to the petitioner as agreed. (R. 26.)

Dividends on the preferred stock were payable at 7 percent a year or, during the first five years of operation and in the discretion of the directors, in common stock at the rate of one share of common stock for each share of preferred. (R. 26, 89.) Dividends upon preferred stock, payable in common stock at the prescribed rate, were declared for the years 1925, 1926, and 1927 (R. 26), and in 1928 a dividend at the rate of one-half share of common stock and $3.50 in cash for each share of preferred was declared (R. 81–82). In each of these years the surplus of the corporation was in excess of a 7-per cent dividend on the preferred stock and, upon issuance each year of the common stock as a dividend, it was charged to surplus at the rate of $7 a share and credited to the common stock account. (R. 26.)

In January 1926 the corporation offered its stockholders of record the right to subscribe for a specified number of preferred and common stock in units of one share of preferred and 50 shares of common stock at $300 a unit. (R. 26–27, 54, 56, 71.) Petitioners exercised this right and purchased from the corporation 15 units, consisting of 15 shares of preferred stock and 750 shares of common stock. (R. 27.)

The petitioner, as the owner of preferred stock of the corporation, received shares of common stock as dividends on her preferred stock as follows (R. 27, 59):

January, 1925	127 shares common stock
January, 1926	150 shares common stock
January, 1927	165 shares common stock
January, 1928	82½ shares common stock

No amount was reported by the petitioner in those years as income representing the dividends received by her in common stock of the corporation. (R. 59.)

In 1930 the 165 shares of preferred stock then owned by the petitioner were redeemed by the corporation and the petitioner received therefor $17,325. (R. 27.)

The Commissioner determined that the prices paid by the petitioner upon her respective purchases of the corporation's stock in 1924 [1] and 1926 were for preferred and common stock together as a block or unit, and accordingly allocated the cost on each purchase to the respective classes of stock according to their values. The Commissioner further determined that the dividends paid in common stock in 1925 to 1928, inclusive, were nontaxable stock dividends, and accordingly the cost of the petitioner's preferred stock in respect of which the dividends were paid was apportioned to the two classes of stock on the basis of their respective values at the time the dividends were received. Thus the cost basis of the petitioner's preferred stock held and redeemed in 1930 was fixed for determination of the gain realized on the redemption

[1] The Board so found as to 1924. (R. 29.)

of such stock. The Commissioner therefore determined a deficiency in the petitioner's income tax for 1930 of $833.48 (R. 13, 20), of which there is $330.98 in dispute here.

The Board of Tax Appeals held that the common stock received by the petitioner during 1925 to 1928, inclusive, as a dividend on her preferred stock was not a nontaxable stock dividend and reversed the action of the Commissioner in making an adjustment of the petitioner's cost basis on that theory. The Circuit Court of Appeals reversed the decision of the Board.

SUMMARY OF ARGUMENT

If the dividends on preferred stock paid to the petitioner in common stock were nontaxable at the time of distribution under Section 115(f) of the Revenue Act of 1928 and Section 201(f) of the Revenue Act of 1926, the Commissioner properly spread the petitioner's cost over both the preferred and common stock in proportion to their respective values, and correctly computed the petitioner's taxable gain on the redemption of her preferred stock in 1930. The real question is whether the several distributions of common stock to the petitioner were nontaxable at the time when made. This is a question of statutory construction of the words "A stock dividend shall not be subject to tax", and there is no necessity to determine whether the distribution was constitutionally immune from tax.

The general meaning of the phrase "stock dividend" connotes any dividend paid by a corporation by a distribution of its new or theretofore unissued stock, and there is no occasion to limit the meaning of the phrase to such stock dividends as may be exempt from taxation for constitutional reasons. If, however, there can be said to be any doubt as to the meaning of the words "stock dividend", the doubt should be resolved in favor of the Commissioner's position by the administrative interpretation of the statute and the fact that the statute has been reenacted without change since it first appeared in the Revenue Act of 1921.

Since the stock dividends here in issue were nontaxable under the statute when received the Commissioner properly apportioned cost under valid regulations. The fact that Section 115 (a) (f) of the Revenue Act of 1928 did not expressly authorize the Commissioner to apportion cost in the case of a stock dividend is not decisive here since the Revenue Act in broad terms authorizes the Commissioner to promulgate rules and regulations needful for the enforcement of the Act. The regulation apportioning cost in a case of this type was needful for the purposes of the Act, consistent therewith, violated no provision of the Act, and has been approved by Congress.

If it be considered that the distributions here involved were not true stock dividends and hence were taxable, the petitioner should now be estopped to assert the fact and to deny that the Commissioner properly treated them as nontaxable stock

dividends and apportioned the petitioner's cost to the two classes of stock. During the years in which the common stock was received by the petitioner as dividends on her preferred stock, the petitioner reported in her tax returns no amount as income on account thereof. The statute provides that all dividends other than stock dividends constitute taxable income and requires that the taxpayer report such dividends in the return for the year in which they are received. In not reporting any of the dividends here in question as taxable dividends, the petitioner represented that they were stock dividends and were not taxable. The Commissioner accepted the petitioner's tax returns for the respective years as made by her, at least in this respect, and determined her tax liability on that basis. The petitioner should not now be heard to say that the distributions to her were taxable to her as dividends in the years of their receipt and were not as she then regarded them—stock dividends and nontaxable.

ARGUMENT

I

THE COMMON STOCK RECEIVED BY PETITIONER AS DIVIDENDS ON PREFERRED STOCK WERE NONTAXABLE STOCK DIVIDENDS

The principal question presented here is whether the distributions of common stock in this case are embraced within the terms of Section 115 (f) of the Revenue Act of 1928, *infra*, and Section 201 (f) of the Revenue Act of 1926, *infra*, both of which sections provide that "A stock dividend shall not

be subject to tax." If the distributions here in issue were stock dividends within the meaning of the statute, the Commissioner's apportionment and allocation of the cost of the petitioner's preferred stock to the common stock received by the petitioner as dividends thereon was correct and the decision of the court below should be affirmed.

Prior to the Revenue Act of 1921, a tax was levied upon all "dividends." Cf. Revenue Act of 1916, Section 2 (a); Revenue Act of 1918, Section 213 (a). Following the decision of this Court in *Eisner* v. *Macomber,* 252 U. S. 189, where it was held that a stock dividend of common stock distributed *pro rata* to common stockholders did not constitute income within the meaning of the Sixteenth Amendment and could not be constitutionally taxed as such at the time of distribution, Congress in enacting the Revenue Act of 1921 expressly provided by Section 201 (d) of the Act that "A stock dividend shall not be subject to tax."[2] The exemption of stock dividends from taxation has been reenacted in all the subsequent Revenue Acts.[3]

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[2] H. Rep. No. 350, 67th Cong., 1st Sess. p. 8: "Section 202 modifies the definition of dividends in existing law by exempting stock dividends from the income tax, as required by the decision of the Supreme Court in *Eisner* v. *Macomber* 252 U. S., 189)." Similar language is contained in S. Rep. No. 275, 67th Cong., 1st Sess. p. 9.

[3] 201 (a) (f), Revenue Act of 1924.
201 (a) (f), Revenue Act of 1926.
115 (a) (f), Revenue Act of 1928.
115 (a) (f), Revenue Act of 1932.
115 (a) (f), Revenue Act of 1934.

The statute (Section 201 (f), *infra,* and Section 115 (f), *infra*), in declaring that a *stock dividend* shall not be subject to tax, does not undertake to define the term. The words of the statute, however, are broad and clear and should be given their plain and generally accepted meaning—that all stock dividends are not subject to tax. There is no qualification contained in the statute and its application can not be restricted, by construction, to the limited class of stock dividends which, under the decision of *Eisner* v. *Macomber, supra,* are constitutionally immune from income tax. It is well settled that when the language of a statute is clear and unambiguous, there is no room for interpretation, *The Cherokee Tobacco,* 11 Wall. 616; *Yerke* v. *United States,* 173 U. S. 439; *Ruggles* v. *Illinois,* 108 U. S. 526, 534; *Reinecke* v. *Smith,* 289 U. S. 172, 174, and the courts "are not at liberty to construe language so plain as to need no construction." *Helvering* v. *City Bank Co.,* 296 U. S. 85, 89.

Moreover, Congress did not limit the exemption from taxation to any particular type or class of stock dividend, or to such a dividend as is constitutionally immune to tax as income; and to do so by construction would, in effect, read into the statute a qualification not therein contained and amend the statute under the pretense of construing it. *Heiner* v. *Donnan,* 285 U. S. 312, 331. In *United States* v. *Goldenberg,* 168 U. S. 95, the Court said (pp. 102–103):

> The primary and general rule of statutory construction is that the intent of the lawmaker is to be found in the language that he has used. He is presumed to know the meaning of words and the rules of grammar. The courts have no function of legislation, and simply seek to ascertain the will of the legislator. It is true there are cases in which the letter of the statute is not deemed controlling, but the cases are few and exceptional, and only arise when there are cogent reasons for believing that the letter does not fully and accurately disclose the intent. No mere omission, no mere failure to provide for contingencies, which it may seem wise to have specifically provided for, justify any judicial addition to the language of the statute.

We submit that the phrase "stock dividends", when given its generally accepted meaning, connotes any dividend paid by a corporation by a distribution to its stockholders of its own new or theretofore unissued stock. The phrase is not limited in meaning only to such a distribution which preserves without change the stockholders' proportionate interest in the corporation or to one which is made in stock of a class similar to that already held by the stockholder. Thompson on Corporations, 3d Ed., Vol. 7, p. 137, Sec. 5263, states: "A stock dividend is what the term itself implies, a distribution of the stock of the corporation among the stockholders as a dividend." Paul

& Mertens, Law of Federal Income Taxation, Vol. 1, Sec. 8.74, defines the phrase as follows:

> Broadly defined, a stock dividend is a distribution of stock certificates of the distributing corporation representing a capitalization of all or part of the undivided profits * * * of the corporation.

In *Equitable Trust Co.* v. *Prentice,* 250 N. Y. 1, the court said (p. 12):

> Stock dividends in the true sense, *i. e.,* dividends capitalizing surplus as distinguished from those payable in the stock of a subsidiary (*People ex rel. Clark* v. *Gilchrist,* 243 N. Y. 173, 178; *U. S.* v. *Phellis,* 257 U. S. 156), have predominantly the quality of an increment to principal, though at times, in furtherance of intention, they have been classified as income. When a dividend is paid in cash, the ownership of the corporate assets is changed; the company owns less, and the shareholder owns more, or something essentially different, though its value be no greater. Upon the distribution of a stock dividend; ownership of the assets is precisely as it was. "A stock dividend does not distribute property, but simply dilutes the shares as they existed before" (*Williams* v. *W. U. Tel. Co.,* 93 N. Y. 162, 189). Whatever gain results to the shareholder from the division of his certificates is indirect and incidental, not extracted from the assets like the recurrent yield of an investment * * *.

In *Whetsel* v. *Forgey,* 323 Mo. 681, 693, a stock dividend was defined as "a dividend paid in stock instead of cash." *Cf. Lamb* v. *Lehmann,* 110 O. S. 59, 78. For further definitions of a stock dividend see *Kaufman* v. *Charlottesville Woolen Mills,* 93 Va. 673, 675–6; *Graves* v. *Graves,* 94 N. J. Eq. 268, 276.

In the instant case common stock was distributed as a dividend on preferred stock, but the fact that the stock distributed as a dividend was not of the same class as that held by the petitioner does not serve to make the distribution of its own stock by the corporation any the less a *stock dividend.* Neither the clear language of the statute nor the meaning of the phrase requires that the stock held and the stock distributed be of the same class.

If there should be any real doubt whether the phrase "stock dividend" embraces generally all dividends paid by a corporation in its new or unissued stock, as distinguished from other forms of property, we submit that such doubt is resolved by the administrative construction of the provision.

Following the decision of *Eisner* v. *Macomber, supra,* T. D. 3052, 3 Cumulative Bulletin 38 (July–December, 1920), was promulgated, which contained among other provisions the following (p. 38):

> 1. Where a corporation, being authorized so to do by the laws of the State in which it is incorporated, transfers a portion of its surplus to capital account, issues new stock

representing the amount of the surplus so transferred, and distributes the stock so issued to its stockholders, such stock is not income to the stockholders, and the stockholders incur no liability for income tax by reason of its receipt.

Moreover, by T. D. 3059, 3 Cumulative Bulletin 38–39, Article 1545 of Regulations 45, which held that a dividend paid in stock of the corporation was income, was revoked, and Article 1547 of Regulations 45, which was to the effect that stock dividends were taxable income under the Revenue Act of 1916, was amended to read in part as follows (p. 39):

> ART. 1547. *Sale of stock received as dividend.—Stock received as a dividend does not constitute taxable income to the stockholder,* but any profit derived by the stockholder from the sale of such stock is taxable income to him. For the purpose of ascertaining the gain or loss derived from the sale of such stock, or from the sale of the stock with respect to which it is issued, the cost (used to include also, where required, the fair market value as of March 1, 1913) of both the old and new shares is to be determined in accordance with the following rules:
>
> (1) Where the stock issued as a dividend is all of substantially the same character or preference as the stock upon which the stock dividend is paid, the cost of each share of both the old and new stock will be the quo-

tient of the cost, or fair market value as of March 1, 1913, if acquired prior to that date, of the old shares of stock divided by the total number of the old and new shares.

(2) *Where the stock issued as a dividend is in whole or in part of a character or preference materially different from the stock upon which the stock dividend is paid,* the cost, or fair market value as of March 1, 1913, if acquired prior to that date, of the old shares of stock shall be divided between such old stock and the new stock, or classes of new stock, in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are issued, and the cost of each share of stock will be the quotient of the cost of the class to which such share belongs divided by the number of shares in that class. (Italics supplied.)

This Treasury Decision was incorporated in Article 1548, Regulations 62, under the Revenue Act of 1921, and subsequent Regulations contain substantially similar provisions.[4]

The Commissioner has consistently provided in Regulations issued since the Revenue Act of 1921 that the phrase "stock dividend" within the meaning of the exemption includes the issuance of its own stock by a corporation to its shareholders.

[4] Articles 1547 and 1548, Regulations 65, 1924 Act; Articles 1547 and 1548, Regulations 69, 1926 Act; Articles 627 and 628, Regulations 74, 1928 Act; Articles 627 and 628, Regulations 77, 1932 Act; Articles 115–7 and 115–8, Regulations 86, 1934 Act.

Articles 1547 and 1548, Regulations 69; Articles 1547 and 1548, Regulations 62 and 65; Articles 627 and 628, Regulations 74 and 77; Articles 115–7 and 115–8, Regulations 86.

The Income Tax Unit has specifically ruled that common stock paid as a dividend on preferred shares is nontaxable. I. T. 2538, IX–1 Cumulative Bulletin 144. *Cf.* T. D. 3059, 3 Cumulative Bulletin 38–39, (2) *supra;* Article 600 (2) of Regulations 74, *infra.*

We do not think that the statute is ambiguous, but, if we err in this respect, we submit that the consistent administrative interpretation of the statute is entitled to great weight and should resolve the doubt, since it is neither unreasonable nor inconsistent with the statute. This Court has repeatedly held that great weight must be accorded continued administrative application and construction of statutory provisions. *National Lead Co.* v. *United States,* 252 U. S. 140, 144–145. Furthermore, the reenactment of the statute without change is persuasive evidence of legislative approval of the administrative interpretation of the statute. *Morrissey* v. *Helvering,* 296 U. S. 344. This legislative approval of the administrative construction requires a conclusion that the regulations are correct, consistent with the legislative intent, and not repugnant to the statute.

The petitioner refers to the Committee Reports [5] on the Revenue Act of 1921 as furnishing support for the argument that the statute exempts from taxation only such "stock dividends" as are constitutionally immune from taxation under *Eisner* v. *Macomber, supra.* It is no doubt true that the decision in that case, holding that stock dividends which do not constitute *income* within the meaning of the Sixteenth Amendment cannot be constitutionally taxed as such, was the underlying reason for the enactment of Section 201 (d) of the Revenue Act of 1921. However, the unambiguous language of the provision "a stock dividend shall not be subject to tax", warrants the conclusion that Congress intended to exempt all stock dividends from tax, and by so doing to avoid perhaps the levying of a tax which, in all probability, would result in controversy as to its constitutionality. This conclusion finds support in the fact that Congress placed no limitation or classification on the nature or type of stock dividend exempted from tax and used language which is so plain in meaning as not to justify resort to Committee Reports for ascertainment of intention. *Helvering* v. *City Bank Co., supra.*

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[5] H. Rep. No. 350, 67th Cong., 1st Sess., p. 8: "Section 202 modifies the definition of dividends in existing law by exempting stock dividends from the income tax, as required by the decision of the Supreme Court in *Eisner* v. *Macomber* (252 U. S. 189)". Similar language is contained in S. Rep. No. 275, 67th Cong., 1st Sess., p. 9.

Moreover, after the decision of this Court in *Eisner* v. *Macomber, supra,* holding that Congress could not constitutionally levy an income tax on a dividend paid in common stock to common stockholders, it was not necessary for Congress to expressly exempt from taxation that which it could not constitutionally tax, and we cannot assume that this was the sole Congressional purpose. The exemption must have been intended to embrace all stock dividends capitalizing surplus of whatever type or class and to remove any doubt as to the taxability of stock dividends other than those of the class involved in *Eisner* v. *Mcomber, supra.* Administrative interpretation and legislative approval of that interpretation support the conclusion.

Moreover, Section 115 (a) of the Revenue Act of 1928, *infra,* which is substantially the same as Section 201 (a) of the Revenue Acts of 1924 and 1926 and Section 201 (a) of the Revenue Act of 1921, defines a "dividend" as "any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913." The definition embraces two classes of dividends, (1) "in money" and (2) "in other property;" but there must be a *"distribution"* (a severance of assets from the corporation) made by the corporation of one or the other, and that from earnings or profits accumulated after February 28, 1913. The

statute does not further define a "dividend", and we submit that it is a fair inference that Congress intended to tax only such dividends as came within its definition of the word "dividend" as used in the Act. In the instant case the corporation made no "distribution * * * out of earnings or profits." To the contrary, the corporation capitalized its earnings and profits to the extent of the stock dividend and rendered them unavailable for the purpose of distribution to stockholders. It follows that the stock dividend here involved does not meet the requirements of Section 115 (a), *infra,* is not taxable as a dividend thereunder, and hence it falls, as Congress intended it to, within the exemption of Section 115 (f), *infra.*

In *Commissioner* v. *Tillotson Mfg. Co.,* 76 F. (2d) 189, the Circuit Court of Appeals for the Sixth Circuit held that dividends on preferred stock paid in common stock were subject to tax, since they constituted income to the recipient. In that case the court pointed out that this Court, in *Eisner* v. *Macomber, supra,* in considering a stock dividend, established two tests for determining whether the stock dividend was taxable or nontaxable. The tests stated by the court were (p. 190): (1) severance of assets from the corporation, and (2) alteration of the preexisting proportionate interest of the stockholders. In the *Tillotson* case the court applied those tests to the stock dividend there involved, and was of opinion that, since the

dividend was paid to preferred stockholders in common stock, and because of inherent differences in the two kinds of stock, the second test was not met and hence the stock dividend could not be deemed a nontaxable stock dividend, as defined in *Eisner* v. *Macomber, supra.* We think that the court in the *Tillotson* case erred in basing its decision solely on tests which had for their purpose the ascertainment of whether a stockholder had received *income* as a result of a stock dividend. The decision, in substance, turns on the fact that, under *Eisner* v. *Macomber, supra,* the stock dividend would have been taxable. The statute exempting stock dividends from tax, as we have said, is not limited to the type of stock dividends involved in the *Macomber* case; and, if this be true, then we submit that the court in the *Tillotson* case should have determined the taxability of the stock dividend under the statute and not by resort to tests of income realization from stock dividends under a Revenue Act which expressly taxed "dividends."

While in the *Macomber* case the stock was all of the one class,—common stock,—it should be noted that the Court in considering the essential character of a stock dividend emphasized the fact that the aggregate assets of the corporation are not affected and the stockholder thereby receives none of the corporate assets. After discussing the relation of the stockholder to the corporation and the necessities of corporate activities requiring the use

of surplus profits in the business, instead of distributing the same as dividends, in which event the amount of profits retained are charged to surplus, credited to capital stock and stock for that amount issued pro rata to the stockholders, the Court said (p. 211):

> A "stock dividend" shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. Far from being a realization of profits of the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution.
>
> The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment.

Whether or not the issuance of the common stock to the petitioner as a dividend on her preferred stock altered the proportionate interest she held in the corporation and its assets, the fact remains that there was no severance of the corporation's assets and the petitioner thereby received none of the corporate assets. The accumulated earnings of the corporation were not distributed, but on the contrary were retained in the business. There has been only an increase of the evidences of her investment; true to some extent different in form, yet her entire original investment, together with the accretions thereto, remain in the corporation with that of other stockholders subject to the risks of the business which might wipe out the entire investment. We submit that the common stock received by the petitioner as a dividend on preferred stock may properly be treated as a stock dividend, under the *Macomber* case. Both the common stock and the preferred stock represented her investment and a portion of the cost of the latter must be allocated to the common stock.

The reasoning of the dissenting opinion in this case (R. 117–118), upon which the petitioner relies (Pet. 7), that the "majority opinion's interpretation would have Congress attempting to tax *CAPITAL* by the device of deducting from capital cost *INCOME* produced from capital in determining the gain on the sale of the stock representing the original investment," is unsound for the reason that it presupposes the stock dividend in its

entirety to be capital. That is no more the case than increase in value between the time of purchase and sale of stock is *capital* to the owner of stock. *Miles* v. *Safe Deposit Co., supra* (p. 252); *Eisner* v. *Macomber, supra* (pp. 214–215). *Merchants' L. & T. Co.* v. *Smietanka,* 255 U. S. 509, 510. In neither case has there been an actual realization of gain by a severance of assets from the corporation.

Peabody v. *Eisner,* 247 U. S. 347; *United States* v. *Phellis,* 257 U. S. 156; and *Marr* v. *United States,* 268 U. S. 536, are not determinative of the question here presented. In those cases it was held that dividends paid by a corporation to its stockholders in stock of another corporation, or in the stock of a corporation not substantially identical with the distributing corporation, were taxable as dividends for the reason that the stockholder received either a part of the distributing corporation's assets or a new and entirely different interest from that formerly held. In each of the cited cases there was a severance of assets from the corporation. Such a distribution is not a stock dividend but a property dividend and the cases have no application here. *Eisner* v. *Macomber, supra* (p. 215); *Peabody* v. *Eisner, supra* (pp. 349–350). The stock of the new corporation, which was distributed by the old corporation to its stockholders, in *Weiss* v. *Stearn,* 265 U. S. 242, was held in that case to be a nontaxable dividend for the reason that, because of the substantial

identity of the two corporations, the stockholder's interest remained the same after the distribution as it was before. That case presented the question whether a pure stock dividend differing in form from that involved in *Eisner* v. *Macomber, supra,* but essentially similar to it because of substantial corporate identities could be constitutionally taxed. Applying the principles of *Eisner* v. *Macomber, supra,* the Court held that it could not. We think that *Weiss* v. *Stearn, supra,* like *Eisner* v. *Macomber, supra,* is distinguishable. If it should be considered that under these cases a stock dividend is essentially one which does alter the stockholder's proportionate interes in the corporation, nevertheless the dividend here is a stock dividend for the purpose of the statute and exempted by it from taxation, regardless of whether under those cases it could have constituted income to the petitioner and might have been constitutionally taxed to her as such. The question here is not what Congress may tax but what has Congress exempted from tax.

It is a matter of conjecture whether the Commissioner's interpretation of Section 115 (f) will operate generally to the advantage of the Treasury or of the taxpayer. In the instant case it is the Treasury which benefits. However, if the Commissioner's interpretation is erroneous, taxpayers similarly situated would be taxable for surtax pur-

poses at the time when the stock dividend is received; whereas under the Commissioner's interpretation the tax would be postponed until sale or other disposition when, because of fluctuation in value, no taxable income might result.

In view of the plain terms of the statute and its long continued administrative interpretation, we submit that the stock dividend here in issue and similar distributions, as the court below held, were exempt from tax at the time when made.

II

IF THE STOCK DIVIDENDS WERE EXEMPT FROM TAX WHEN RECEIVED THE COMMISSIONER PROPERLY APPORTIONED COST UNDER VALID REGULATIONS

The petitioner urges (Br. 26–34) that even if we are correct in the contention that the common stock dividend in this case was exempt from tax by the statute, it was nevertheless improper for the Commissioner by his regulations to allocate the cost of the preferred stock originally purchased between both the original preferred and the common stock received as dividends, in the absence of express statutory authority. The regulations referred to are Articles 58, 628, and 600 of Regulations 74, *infra*. This contention is without merit.

The fact that there is no express statutory authority to issue regulations upon a given statutory provision clearly would not render invalid a regulation in respect thereto. The conclusion that such is the case would render meaningless the broad

power given the Commissioner under the Revenue Acts to issue regulations needful for the enforcement of the Act. Cf. Regulations 74, Article 62. Numerous instances may be cited of regulations issued and approved upon a given subject in which there was no specific statutory authority or command.

For example, in the absence of express statutory provision under Section 22 of the Revenue Act of 1928, the Commissioner promulgated the so-called "first-in, first-out" rule in the first two sentences of Article 58 of Regulations 74. That provision of the regulations has been upheld as valid. *Helvering* v. *Rankin,* 295 U. S. 123; *Snyder* v. *Commissioner,* 295 U. S. 134, 141. Where a statute provided that the basis of property acquired by bequest, devise, or inheritance should be the fair market price at the time of acquisition, this Court approved the Commissioner's regulations providing that the value at the time of the death of the decedent should be taken as the basis for ascertaining gain from the sale of property acquired by bequest or descent. *Brewster* v. *Gage,* 280 U. S. 327. And in *Hartley* v. *Commissioner,* 295 U. S. 216, this Court approved regulations providing that the basis in the hands of the decedent's estate should be the value at the date of the decedent's death rather than cost to the decedent, where the statute had only provided cost as the basis. In *Fawcus Machine Co.* v. *United States,* 282 U. S. 375, this Court, in an invested capital case, ap-

proved the Commissioner's regulation with respect to the treatment of taxes levied against the taxpayer, in the absence of any express statutory authority to issue a ruling upon the subject.

A situation not unlike that disclosed here exists in cases of an exchange in a corporate reorganization of one class of old stock for two classes of new stock. In the case of reorganization, no gain or loss being recognized on the exchange of stock, the cost of the old stock is substituted as the cost of the new. Cf. Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 202 (c) (2) and (d) (1). The statute in such case did not provide for an apportionment of the cost of the old stock over the respective classes of the new stock. But the regulations did so provide (cf. Regulations 62, Art. 1567), and they have been approved as a correct exposition of the legislative intent (*Houghton* v. *Commissioner,* 71 F. (2d) 656 (C. C. A. 2d), certiorari denied, 293 U. S. 608; *Curtiss* v. *Commissioner,* 57 F. (2d) 847 (C. C. A. 5th). Cf., also, *Taylor* v. *Commissioner,* 70 F. (2d) 619 (C. C. A. 2d); *Helvering* v. *Taylor,* 293 U. S. 507).

Moreover, in *Miles* v. *Safe Deposit Co.,* 259 U. S. 247, this Court, after characterizing a stockholder's right to subscribe to the corporation's new stock by saying that such right was essentially analogous to a stock dividend, held that a portion of the cost of the stockholder's original stock should be allocated to the right, as was provided for in the case of stock dividends under Article 1547 (1) of Regulations 45, promulgated under

Section 201 of the Revenue Act of 1918, which did not expressly authorize the Commissioner to apportion or allocate cost in such a case.

The regulation attacked by the petitioner was necessary to carry out the provisions of the Act. The Act provided that a stock dividend shall not be subject to tax. In view of this provision it was necessary in the administration of the Revenue Act to determine the amount of gain taxable upon a later sale of the stock upon which the dividend was declared as well as the dividend stock. This is a plain case in which regulations were needful. Furthermore, they truly interpret the provisions of the Act and are not inconsistent therewith.

Congress in exempting all stock dividends from tax saw fit to treat a stock dividend of whatever kind as merely additional evidence of a capital interest of the stockholder representing property allowed to remain with the corporation, the sum of all these evidences of interest representing his capital investment in the corporation. Such being the intent, it is clearly consistent therewith to spread the original cost of the stockholder's capital investment over his whole capital interest now existing in the corporation. Indeed, it is necessary to do this, for otherwise the basis would not be *the cost of the property sold,* which is the true statutory basis. See *United States* v. *Ludey,* 274 U. S. 295. The regulation does not have the effect of taxing the stockholder's capital, which is all

returned to him upon the sale of all the stock representing his retained capital interest.

A regulation not inconsistent with the statute and reasonably adapted to carry out the legislative intent is valid. *National Lead Co.* v. *United States, supra.* Adopting the test in *Manhattan General Equipment Co.* v. *Commissioner*, decided by this Court February 3, 1936 (rehearing denied, March 2, 1936), cited by petitioner (Br. 29), we submit that the regulation is consistent with the statute exempting a stock dividend from taxation and is reasonable. It constitutes a fair attempt to carry into effect the legislative intent and violates no provision of the statute. *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406, 414.

Congress, no doubt, could have expressly provided in the statute, that in a case of the type here involved, a portion of the cost of the original stock should be allocated to the stock distributed as a dividend, but its failure to do so specifically does not, of itself, render the regulations so providing invalid. *LaMotte* v. *United States,* 254 U. S. 570, 576. Congress, in broadly authorizing the Commissioner to prescribe regulations needful for the enforcement of the Revenue Acts, did so because of a realization that a Revenue Act was not, in itself or its separate provisions, complete and that regulations were necessary to bridge the gaps left by the letter of the law and to minimize inequalities. *United States* v. *Grimaud,* 220 U. S.

506, 517. For this reason, we submit, it was unnecessary to the validity of the regulations here involved that Congress expressly provide, by Section 115 (a) (f), *infra,* that the Commissioner was authorized to prescribe regulations allocating a portion of the cost of old stock to the dividend stock, in the case of a stock dividend, or that such allocation should be made under regulations prescribed by the Commissioner. *Heiner* v. *Tindle,* 276 U. S. 582.

If, as the petitioner concedes (Br. 32), it is proper to allocate the original cost of common stock over new common stock received as a dividend, rather than to assign the whole cost to the shares originally purchased, it is equally proper to allocate the cost in the case of shares of a different character where the distribution is tax-exempt.

The regulation providing for the allocation of cost over the old and the new dividend stock has been in effect under numerous Revenue Acts (see pages 13–16, *supra*), and the reenactment of the revenue laws without change evidences legislative approval (*Brewster* v. *Gage, supra; Morrissey* v. *Helvering, supra*). If this were contrary to the legislative intent it is reasonable to suppose that the practice would have been corrected in some of the revisions of the revenue laws. *Heiner* v. *Colonial Trust Co.,* 275 U. S. 232.

III

THE PETITIONER IS ESTOPPED TO DENY THE COMMON STOCK RECEIVED AS A DIVIDEND ON PREFERRED STOCK WAS A STOCK DIVIDEND

If the Court should be of the opinion that the common stocks received as dividends on petitioner's preferred stock were not in fact stock dividends and nontaxable, then under the circumstances of this case we submit the petitioner is estopped to assert the fact to avoid the tax upon the direct gain resulting from the disposition of the preferred stock in a later year. If the common stocks were not received as stock dividends within the meaning of the statute, they were property dividends and taxable income in the years in which they were received and the statute required that the petitioner report such income on her tax returns. Sections 201 (a) (b), 213 (a), Revenue Act of 1926, c. 27, 44 Stat. 9. The petitioner, however, did not include in her returns for the years 1925–1928, inclusive, any taxable income on account of the common stocks received as dividends during those years. (R. 59.) The petitioner's tax returns, as made by her from 1925 to 1928, inclusive, were accepted by the Commissioner in this respect and by failing to report thereon the dividends and common stock, the petitioner represented that no taxable dividends on her preferred stock had been received in those years. She should not now be heard to say that the dividends and

common stock were taxable dividends in the years of receipt and not nontaxable stock dividends, as she impliedly represented. When the result of such change of position is to defeat the proper apportionment of her preferred stock costs, and the tax upon the gain realized by her on the redemption of her preferred stock in 1930, a party cannot, having represented one state of facts to exist and led others to rely thereon, deny the fact and assume an inconsistent position. See *Casey* v. *Galli,* 94 U. S. 673, 680; *Morgan* v. *Railroad Co.,* 96 U. S. 716, 720; *Central Pacific Railroad* v. *California,* 162 U. S. 91, 113–114.

The petitioner now, after the statute of limitations has run, attempts to reverse the position taken by her in the years when she received the common stock as stock dividends. The existence of these elements is all that is required to establish equitable estoppel. *Stone* v. *Bank of Commerce,* 174 U. S. 412; *Kirk* v. *Hamilton,* 102 U. S. 68; *Dickerson* v. *Colgrove,* 100 U. S. 578; *Oklahoma* v. *Texas,* 268 U. S. 252.

The principle that a litigant may not found his claim on his own inequity or wrong is forcibly enunciated by this Court in the case of *Stearns Co.* v. *United States,* 291 U. S. 54. In that case the Court said (pp. 61–62):

> The applicable principle is fundamental and unquestioned. "He who prevents a thing from being done may not avail himself of the non-performance which he has himself

> occasioned, for the law says to him in effect 'this is your own act, and therefore you are not damnified.'" * * * Sometimes the resulting disability has been characterized as an estoppel, sometimes as a waiver. The label counts for little. Enough for present purposes that the disability has its roots in a principle more nearly ultimate than either waiver or estoppel, the principle that no one shall be permitted to found any claim upon his own inequity or take advantage of his own wrong. * * * A suit may not be built on an omission induced by him who sues.

In *Bothwell* v. *Commissioner,* 77 F. (2d) 35 (C. C. A. 10th), the taxpayers in 1927 purchased stock of a corporation, of which they were officers, for a price far below its fair market value. In 1928 they sold such stock and contended that the profit on the sale was the difference between the fair market value of the stock on the date they acquired it in 1927 and the selling price in 1928. They claimed that the difference between the price at which they purchased it and its fair market value was compensation for personal services rendered the corporation, but they had not reported such difference in their income tax returns for the year 1927, and at the time they first made such contention the statute of limitations had expired for that year. In holding that they were estopped to claim the fair market value in 1927 as the basis for measuring the profit on the sale, the court said (p. 37):

> By failing to report such income, each in effect declared that no such income had been received by him. *Crane* v. *Commissioner* (C. C. A. 1) 68 F. (2d) 640, 641. Furthermore, up to the time the amended petitions were filed, each had asserted that the income received by him was capital gain rather than compensation for services. At the time the amended petitions were filed the statute of limitation had run as to the 1927 taxes.
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> * * * * *
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> Darby and Bothwell each having declared in 1927 that no part of the value of the stock was compensation for services, and having continuously asserted from 1928 until after the statute of limitation had run against taxes for 1927, that the whole of the profit derived from the sale of such stock was capital gain, they are now precluded from asserting that a portion of the value of such stock was compensation for services. They are barred from so doing by their wrongful acts and omissions.

In *Larkin* v. *United States,* 78 F. (2d) 951 (C. C. A. 8th) the taxpayers who had purchased from their employer at $100 per share stock having a fair market value of $250 per share subsequently on the sale of that stock, attempted to show a loss by basing the cost on the market value. The court held that the failure of the taxpayers to report the difference in their income tax returns for the year in which the stock was purchased estopped them from maintaining the suit.

In *Askin & Marine Co.* v. *Commissioner,* 66 F. (2d) 776 (C. C. A. 2d), the taxpayer, conceding that a deduction for bad debts in 1920 was properly disallowed by the Commissioner because the debts were not ascertained to be worthless in that year, contended that the collections in 1920 of amounts similarly charged off in earlier years and allowed as deductions, although not ascertained to be worthless in the year of charge-off, could not be included in its income for 1920. The court, denying the contention, said (p. 778):

> Having represented that it had ascertained these accounts charged off its active file to be worthless and having received the benefit of the deduction it claimed when the commissioner took its representation of the ascertainment of worthlessness at its face value, we think the petitioner is now clearly estopped from denying, to the prejudice of the government, the truth of the representations upon which it has succeeded in former years in obtaining deductions from its gross income. While the commissioner must investigate returns to satisfy himself of their correctness in fact and law, a taxpayer may not benefit at the expense of the government by misrepresenting facts under oath; by succeeding in having the commissioner accept its representations as the truth; and by claiming later that what it represented to be true might have been found false had the commissioner refused to have faith in the sworn return. * * *

In *Hartwell Mills* v. *Rose,* 61 F. (2d) 441 (C. C. A. 5th), it was held that the taxpayer could not contend that certain assessments were void. The court said that taxation is a practical matter having to do with matters which ought to be, and normally are, disposed of informally; that where rights have been substantially preserved, proceedings will not be defeated by defects in form. The court then said (p. 444):

> Especially is it true that, where the government and the taxpayer, by acquiescence in the manner of performing an act, have given a definite character and effect to it, the taxpayer will not be permitted, after deriving benefits from this acquiescence, to deny this character and effect to it, or to change his position at the government's expense.

In *Helvering* v. *Salvage,* decided by this Court January 13, 1936, the question of estoppel had not been raised before the Board and should not have been considered by the Circuit Court of Appeals. *General Utilities Co.* v. *Helvering,* 296 U. S. 200. The Court in the *Salvage* case said of the estoppel question in that case: "Furthermore, the facts disclosed give it no support." That is not the situation in the instant case. Here the issue of estoppel was raised before the Board by the Commissioner's answer (R. 24), and decided against the Commissioner by the Board (Memorandum Opinion, R. 31). The holding of the Board of Tax Appeals in the instant case on the question of estoppel was assigned by the Commissioner as error in his peti-

tion for review filed with the Circuit Court of Appeals. (Petition for Review, Par. 14, 15, R. 38.) We submit that the facts presented on the record of this case furnish support to the contention.

The petitioner having omitted on her returns any amount for the common stock as taxable dividends in the years of receipt represented that they were not taxable dividends but were stock dividends. Those returns were accepted by the Commissioner. The petitioner should not now be heard to say that the shares of common stock were taxable dividends when received and not stock dividends which proportionately reduced the cost of the preferred stock in respect of which they were issued, so that the taxable gain on the later disposition of the preferred must be measured by the original cost without regard to the common stock received free from tax. See *Askin & Marine Co.* v. *Commissioner, supra.*

The Circuit Court of Appeals in deciding the instant case did not pass on the question of estoppel and we submit that, if the Court is of opinion that the stock dividends here involved were not nontaxable stock dividends, the Court should hold that the petitioner is estopped to assert that fact in these proceedings, or remand this case to the Circuit Court of Appeals with directions to that court to pass on the question.

CONCLUSION

The decision of the Circuit Court of Appeals is correct and should be affirmed. In the event that the Court be of opinion that the Circuit Court of Appeals erred in holding the stock dividend share involved to be nontaxable, then we submit that the Court should hold the petitioner is estopped to contend in these proceedings that the stock dividends were taxable, or remand this case to the Circuit Court of Appeals with directions that it pass on the question.

Respectfully submitted.

STANLEY REED,
Solicitor General.

ROBERT H. JACKSON,
Assistant Attorney General.

DAVID E. HUDSON,
SEWALL KEY,
BERRYMAN GREEN,
Special Assistants to the Attorney General.

APRIL 1936.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791, 822, 842:

> SEC. 115. DISTRIBUTIONS BY CORPORATIONS.
>
> (a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.
>
> * * * * *
>
> (f) *Stock dividend.*—A stock dividend shall not be subject to tax.
>
> * * * * *

Section 201 (a) (f), Revenue Act of 1926, c. 27, 44 Stat. 9, and, so far as material here, Section 201 (a) (f), Revenue Act of 1924, c. 234, 43 Stat. 253, are substantially the same as the Section above quoted.

Treasury Regulations 74:

> ART. 58. *Sale of stock and rights.*—* * * In the case of stock in respect of which any stock dividend was paid, the basis for determining gain or loss from a sale of a share of such stock shall be ascertained in accordance with the principles laid down in article 600. Where common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between such common stock and the securities purchased for the purpose of determining the portion of the cost attributable to each class of stock or securities, but if that should be

impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost.

ART. 600. *Stock or securities distributed in reorganization.*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 112 (g) and article 576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules:

(1) Where the stock distributed in reorganization is all of substantially the same character or preference as the stock in respect of which the distribution is made, the basis of each share will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock

are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class.

(3) Where the stock in respect of which a distribution in reorganization is made was purchased at different times and at different prices, and the identity of the lots cannot be determined, any sale of the original stock will be charged to the earliest purchases of such stock (see article 58), and any sale of the stock distributed in reorganization will be presumed to have been made from the stock distributed in respect of the earliest purchased stock.

(4) Where the stock in respect of which a distribution in reorganization is made was purchased at different times and at different prices, and the stock distributed in reorganization cannot be identified as having been distributed in respect of any particular lot of such stock, then any sale of the stock distributed in reorganization will be presumed to have been made from the stock distributed in respect of the earliest purchased stock.

ART. 628. *Stock dividends.*—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which it is issued, shall be determined as provided in articles 561 and 600.

The provisions of Treasury Regulations 65, promulgated under the Revenue Act of 1924, and Treasury Regulations 69, promulgated under the Revenue Act of 1926 (Articles 39, 1548, and 1599), so far as material, are substantially the same as the above-quoted provisions of Treasury Regulations 74.

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Supreme Court of the United States

October Term, 1935

No. 774

CORINNE S. KOSHLAND,
Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF *AMICUS CURIAE.*

Motion for Leave to File a Brief as *Amicus Curiae* in Support of Judgment of the Circuit Court of Appeals in Favor of the Respondent.

ROGER S. BALDWIN,
Amicus Curiae,
120 Broadway,
New York City.

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Motion for Leave to File a Brief as *Amicus Curiae* in Support of Judgment of the Circuit Court of Appeals in Favor of the Respondent.

Motion.

Now comes ROGER S. BALDWIN, an attorney and counsellor of this Court, and represents that there is involved in this case the question of the proper interpretation of the provisions of the applicable revenue acts providing that "a stock dividend shall not be subject to tax".

This question vitally affects the interests of four of his clients who are now involved with the Treasury De-

partment in a controversy as to whether or not certain stock dividends received by them are subject to income tax. The stock dividends in question were paid in preferred stock on common stock and the Treasury Department is holding that, under the authority of the Board of Tax Appeals in this and certain recent cases, such stock dividends must be held to be taxable. This, however, is contrary to the previous rulings of the Treasury Department itself. The possible aggregate liability of these four taxpayers under the decision of the Board of Tax Appeals involved in this appeal may amount to as much as $6,000,000.

The decision and opinion in this case may determine the question of the taxability of such stock dividends received by such four taxpayers.

The Solicitor General on behalf of the respondent has no objection to the filing of an *Amicus Curiae* brief herein. The attorney for the petitioner has consented to the filing of the accompanying brief.

Therefore, he prays leave as *Amicus Curiae* to file the brief submitted herewith in support of the affirmance of the judgment of the Court below.

BRIEF *AMICUS CURIAE.*

Opinions Below.

The case was decided by the Board of Tax Appeals in a memorandum opinion which was not published. The opinion of the Circuit Court of Appeals is reported in 81 Fed. (2d) 641.

Question Presented.

Although the actual question involved in this appeal is the basis which the taxpayer should use in determining gain or loss from the sale or other disposition of preferred stock on which dividends in common stock have been received, the fundamental issue is whether dividends paid by a corporation in shares of *its own capital stock* are subject to Federal income taxation.

Statutes and Regulations Involved.

The statutes and regulations involved are set forth in this brief under their appropriate headings.

Statement of the Case.

At the beginning of the year 1930, petitioner owned 165 shares of the preferred stock of Columbia Steel Corporation, which she had purchased in the years 1924 and 1926 at a total cost of $14,996.11 (R. 108). The articles of incorporation of the Columbia Steel Corporation provided that its preferred stockholders should be entitled to receive annually dividends of $7 per share, payable in cash, or, at the option of the corporation, in common stock in the ratio

of one share of common stock for one share of preferred. Exclusive voting rights were vested in the common stock (R. 108).

During the period from 1925 to 1928, inclusive, the corporation elected to pay the preferred dividends in common stock, and the petitioner received in those years the aggregate number of 524½ shares of common stock as dividends on her preferred stock (R. 109). In 1930, the corporation redeemed its preferred stock at $105 per share, the petitioner receiving the sum of $17,325 for the 165 shares which she then held (R. 109).

The respondent, in determining the petitioner's gain from this redemption, adjusted her cost basis of the preferred stock by apportioning the cost of $14,996.11 between that stock and the common stock in proportion to their respective values, thereby reducing the cost basis of the petitioner's preferred stock to $11,505.80, and thereby increasing her capital gain (R. 109).

The Board of Tax Appeals, in its memorandum opinion, held that the Commissioner's adjustment was erroneous for the reason that the common stock dividends were not exempt from taxation when received, either under the applicable statutes or under the Constitution and, consequently, that the petitioner taxpayer was not obliged to reduce the actual cost of her preferred stock in arriving at her cost basis for use in determining her gain or loss upon the redemption of such preferred stock (R. 25-32).

The Commissioner appealed to the Circuit Court for the Ninth Circuit, which reversed the decision of the Board on the ground that the common stock was exempt from taxation under the appropriate revenue acts, and sustained the regulations of the respondent requiring the apportionment of the cost between the two classes of stock (R. 108-116).

This brief supports the original decision of the Commissioner and the decision of the Circuit Court for the Ninth Circuit.

Summary of Argument.

During a period of approximately sixteen years following the decision in *Eisner* v. *Macomber,* 252 U. S. 189, in March, 1920, the Treasury Department, through its official regulations, uniformly granted exemption to all dividends paid in stock of the paying corporation.

The first dissenting voice was that of the Board of Tax Appeals in the case of *Tillotson Manufacturing Co.* v. *Commissioner,* 27 B. T. A. 913 (1933), which was affirmed by the Circuit Court for the Sixth Circuit in 76 Fed. (2d) 189 (1935). There was, however, a strong dissenting opinion in the Board of Tax Appeals. That case presented substantially the same question involved in the instant case. In the cases of *Torrens* v. *Commissioner,* 31 B. T. A. 787 (1934), and *Gowran* v. *Commissioner,* 32 B. T. A. 820 (1935), the Board held, either directly or inferentially, that a dividend in preferred stock on common stock distributed when there was outstanding other preferred stock of the same preference and classification, was not entitled to immunity from taxation either under the applicable statutes or under the Constitution. In each of these two cases, also, there was a strong dissenting opinion.

In the *Tillotson* case, the Circuit Court held that the stock dividend there involved was not *constitutionally* exempt from taxation. The decision is silent in regard to the *statutory* exemption. In the instant case, the Circuit Court held that the dividends were exempt from taxation under the applicable provisions of the taxing statute. Consequently the Court did not consider the Constitutional exemption.

This brief maintains the following proposition:

> The challenged stock dividends were exempt from taxation under the applicable provisions of the Revenue Acts of 1924, 1926 and 1928, which expressly provide that a stock dividend shall not be subject to tax.

ARGUMENT.

POINT.

The stock dividends in dispute were expressly exempt from taxation under the Revenue Acts.

The statutes in effect when the stock dividends were received contain the simple and direct legislative command that "A stock dividend shall not be subject to tax" (Section 201 (f), Revenue Acts of 1924 and 1926; Section 115 (f), Revenue Act of 1928).

The term "stock dividend" is of general use in corporate parlance and is universally accepted and understood as meaning a dividend paid by a corporation in shares of its own stock (14 Cor. Juris 812).

Black's Law Dictionary, 3rd ed., page 601, defines a stock dividend as follows:

> "One paid in stock, that is, not in money, but in a proportional number of shares of the capital stock of the company, which is ordinarily increased for this purpose to a corresponding extent."

Thompson on Corporations, 3rd ed., Vol. 7, page 137, Sec. 5263, defines the term as follows:

> "A stock dividend is what the term itself implies, a distribution of the stock of the corporation among the stockholders as a dividend."

In *Hayes* v. *St. Louis Union Trust Co.*, 317 Mo. 1028, the Court said at page 1045:

> "A stock dividend is not in any true sense a dividend at all. The latter implies a *division*, a severance from the corporate assets of the subject of the dividend, and a distribution thereof among the stockholders. * * * The issuance of a stock dividend is, in its last analysis, nothing more than an incident or process in corporation bookkeeping."

In *United States* v. *Siegel*, 52 Fed. (2d) 63, the Court defined this term as follows:

> "A stock dividend is a conversion of surplus or undivided profits into capital stock, which is distributed to stockholders in lieu of a cash dividend. It implies a continuance of the corporation with the same assets and the same liabilities" (p. 65).

The Court of Appeals of the State of New York, in the recent case of *Equitable Trust Co.* v. *Prentice*, 250 N. Y. 1, characterized it as follows:

> "Stock dividends in the true sense, i. e., dividends capitalizing surplus as distinguished from those payable in the stock of a subsidiary * * *, have predominantly the quality of an increment to principal, * * *" (p. 12).

See also *United States* v. *Mellon*, 279 Fed. 910, affd. 281 Fed. 645; *United States* v. *Davison*, 1 Fed. (2d) 465, affd. 9 Fed. (2d) 1022, certiorari denied 271 U. S. 670; *Plainfield Trust Co.* v. *Bowlby*, 107 N. J. Eq. 68; *Whetsel* v. *Forgey*, 323 Missouri 681; *United States Trust Co.* v. *Cowin*, 121 Neb. 427; *Graves* v. *Graves*, 94 N. J. Eq. 268; *Kaufman* v. *Charlottesville Woolen Mills*, 93 Va. 673.

It is a cardinal principle of statutory construction that the language of a statute, if clear and unambiguous, is de-

terminative of its meaning and application. This rule was stated in the case of *Adams Express Co.* v. *Kentucky,* 238 U. S. 190, as follows:

> "It is elementary that the first resort with a view to ascertaining the meaning of a statute, is to the language used. If that is plain there is an end to construction, and the statute is to be taken to mean what it says" (p. 199).

In *Van Camp & Sons Co.* v. *American Can Co.,* 278 U. S. 245, the Court again declared this principle in unmistakable language:

> "The words being clear, they are decisive. There is nothing to construe. To search elsewhere for a meaning either beyond or short of that which they disclose is to invite the danger, in the one case, of converting what was meant to be open and precise, into a concealed trap for the unsuspecting, or, in the other, of relieving from the grasp of the statute some whom the legislature definitely meant to include" (p. 253).

In *Lynch* v. *Alworth-Stephens Co.,* 267 U. S. 364, the Court said:

> "And the plain, obvious, and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover" (p. 370).

The Treasury Department, in its official regulations and Treasury decisions, and Congress, in its previous Acts, have uniformly applied the term "stock dividend" as meaning a dividend paid by a corporation in shares of its own stock.

This Court held in the case of *Eisner* v. *Macomber, supra,* decided on March 8, 1920, that Congress lacked authority under the 16th Amendment to tax stock dividends. Following the decision in the *Macomber* case, the Treasury Department, on August 4, 1920, issued T. D. 3052, 3 C. B. 38, which reads, in part, as follows:

> "The following applications of the decision of the Supreme Court of the United States in the case of Eisner v. Macomber in the determination of the taxability of dividends declared by corporations are published for the information and guidance of Internal Revenue officers and others concerned:
>
> 1. Where a corporation, being authorized so to do by the laws of the State in which it incorporated, transfers a portion of its surplus to capital account, issues new stock representing the amount of the surplus so transferred, and distributes the stock so issued to its stockholders, such stock is not income to the stockholders, and the stockholders incur no liability for income tax by reason of its receipt."

On August 16, 1920, the Treasury Department issued T. D. 3059, 3 C. B. 38, revoking Articles 1545, 1546 and 1642 of Regulations 45 (1919), and amending Article 1547 of those Regulations to read as follows:

> "Stock received as a dividend does not constitute taxable income to the stockholder, but any profit derived by the stockholder from the sale of such stock is taxable income to him. For the purpose of ascertaining the gain or loss derived from the sale

of such stock, or from the sale of the stock with respect to which it is issued, the cost (used to include also, where required, the fair market value as of March 1, 1913) of both the old and new shares is to be determined in accordance with the following rules:

1. * * *

2. Where the stock issued as a dividend is in whole or in part of a character or preference materially different from the stock upon which the stock dividend is paid, the cost, or fair market value as of March 1, 1913, if acquired prior to that date, of the old shares of stock shall be divided between such old stock and the new stock, or classes of new stock, in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are issued, and the cost of each share of stock will be the quotient of the cost of the class to which such share belongs divided by the number of shares in that class."

In the Revenue Act of 1921, the first Revenue Act enacted after the decision in the *Macomber* case, Congress expressly declared in Section 201 (d) that "A stock dividend shall not be subject to tax * * *." Thereafter the Treasury Department continued in effect the same Regulations and Decisions which it issued in consequence of the decision in the *Macomber* case. The Regulations interpretative of the Revenue Act of 1921 provided, in part, as follows (Article 1548, Regulations 62 (1922)):

"Stock issued by a corporation as a dividend does not constitute taxable income to a stockholder in such corporation, but gain may be derived or loss sustained by the stockholder from the sale of such stock."

Article 1548 of Regulations 65 (1925), governing the administration of the Revenue Act of 1924, provided, in part, as follows:

> "The issuance *of its own stock* by a corporation as a dividend to its shareholders does not constitute taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock." (Italics supplied.)

The Regulations governing the administration of the more recent Revenue Acts are substantially identical with Article 1548 of Regulations 65. (Article 1548, Regulations 69 (1926); Article 628, Regulations 74 (1929); Article 628, Regulations 77 (1933); Articles 115-8, Regulations 86 (1935).).

We find, therefore, that both before and after the enactment of the Revenue Act of 1921, the Treasury Department has construed the term "stock dividend" as meaning any dividend paid by a corporation in its own stock. The Treasury Regulations and Decisions, above cited, establish clearly that the Treasury Department considered that a dividend paid in stock of a classification other than that on which it was paid, was an exempt stock dividend.

There is no indication in any of the Revenue Acts or in any of the Regulations that Congress or the Treasury Department intended to limit the term "stock dividend" to cases where common stock was paid on common stock or where the distribution did not effect a change in the pre-existing interests of the shareholders.

Following the issuance of T. D. 3059 (1920), amending Article 1547 of Regulations 45 (1919), quoted above, the Treasury Department issued O. D. 732, 3 C. B. 39, (1920), giving specific instructions as to the method of adjusting the cost of both classes of stock where preferred stock is issued as a dividend on common stock.

This Court has frequently declared that a statutory term will be construed as synonymous with the previous and contemporaneous interpretation of the Administrative Department of the Government.

In *United States* v. *Falk*, 204 U. S. 143, this Court said:

> "And the Attorney General's opinion cannot be overlooked. The proviso which he construed in Section 50 of the act of 1890 was re-enacted in § 33 of the act of 1897. It would be extreme to hold that Congress by doing so intended to set up the technical rule relating to provisos against the construction of the Attorney General, and to change that construction by repeating the very words construed" (p. 150).

Again, in *Provost* v. *United States*, 269 U. S. 443, Mr. Justice STONE stated this principle as follows:

> "We can find in this history no substantial basis for the contention that there was a legislative adoption of any settled administrative construction of the statute adverse to the position now taken by the government. On the contrary, the enactment of the Revenue Act of 1918 without material change of the provision in question must, we think, be taken as indicating a purpose to continue in force the existing law as interpreted by the Attorney General (United States v. Falk, 204 U. S. 143, 51 L. ed. 411, 27 Sup. Ct. Rep. 491); and when Congress adopted in the amended Law of 1921 the very suggestion made and rejected two years before, it then intended to effect a change in the law as it had previously existed. Smietanka v. First Trust & Sav. Bank, 257 U. S. 602, 66 L. ed. 391, 42 Sup. Ct. Rep. 223" (p. 458).

The Congress in earlier Revenue Acts had already given a meaning to the term "stock dividend." Section 31 (a) of the Revenue Act of 1917, in so far as is here material, provided as follows:

> "That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, * * * which *stock dividend* shall be considered income to the amount of the earnings or profits so distributed" (Italics supplied).

A similar provision was contained in the Revenue Act of 1916 (Section 2 (a)).

We thus find that both before and after the so-called stock dividend cases, both the Congress and the Treasury Department had accepted the term "stock dividend" as meaning a dividend paid by a corporation in its own stock. The terms "a dividend paid in stock of the corporation" and "stock dividend" are used interchangeably both in the Revenue Acts and in the Treasury Department Regulations (Art. 106, Regulations 33, Rev. (1918); Art. 1545 and Art. 1547, Regulations 45 (1919); Treasury Decision 3052, 3 C. B. 38 (1920)).

Where the Administrative Department of the Government has for a long period of years accepted the statute as meaning just what it says, and Congress, with the knowledge of the meaning given to the language, has repeatedly used the same language in successive Revenue Acts, there should be no question at this late date as to what the language means.

The Circuit Court for the Ninth Circuit based its decision in this case upon the established principle for which we are now contending. The Court said:

> "We are here dealing with revenue acts which expressly exempt all stock dividends from taxation. The question here is not what Congress could tax, but what it has taxed. * * *

> The Tillotson decision, in effect, adds to this section the words 'provided such dividend is already constitutionally exempt from taxation.' This proviso is not found in the Revenue Acts and should not be added thereto by judicial construction.
>
> We hold that the term 'stock dividend,' as used in the Revenue Acts of 1924, 1926 and 1928, embraces all stock dividends, including those paid in common stock of a corporation to holders of its preferred stock. Whether such dividends constitute income, it is unnecessary to decide. If they are not income, they are exempt from taxation under the Sixteenth Amendment. If they are income, they are still exempt by express provisions of these Acts" (R. 112, 113).

In reliance on the plain language of the Revenue Acts and the Rulings of the Treasury Department, many corporations, particularly family corporations, the stock of which is closely held, have paid dividends in stock of a different classification from the stock on which the dividends were declared. Many of the recipients of these dividends will be subject to large additional taxes if the decision of the Board of Tax Appeals in this case is sustained. To assert liability to tax under such circumstances is to say, that a taxpayer acts at his peril in relying upon the simple, direct and unambiguous language of a statute, as interpreted and applied by the Administrative Department of his Government, over a long period of years, with the full knowledge of Congress.

The fundamental fallacy underlying the decisions of the Board and of the Circuit Court for the Sixth Circuit in the *Tillotson* case, as it seems to us, is the assumption that Congress intended to exempt from tax only such special types of stock dividends as under the doctrine laid down in the case of *Eisner* v. *Macomber,* Congress was without constitutional authority to tax.

It is true that the provision inserted in the Revenue Act of 1921 exempting stock dividends from tax was prompted by the decision of the Supreme Court of the United States in the case of *Eisner* v. *Macomber,* but it is unreasonable to impute to Congress the intention that each time the management of a corporation desired to declare a dividend payable in stock, they would have to determine the question as to whether or not the particular stock dividend which they desired to declare was one which was exempt from tax under the Constitution of the United States. If the stock dividend to be declared varied in any substantial degree from the particular type of dividend involved in the case of *Eisner* v. *Macomber,* neither the management of the corporation, the shareholders of the corporation, nor the Administrative Department of the Government could tell with certainty whether such stock dividend would be subject to tax. The administration of the law would become involved in endless chaos and confusion. It is more reasonable to assume that Congress meant just what it said, that "a stock dividend shall not be subject to tax," and that it intended the term "stock dividend" to include any dividend paid by a corporation in shares of its own stock—the meaning which the Treasury Department had uniformly given to the term and which was commonly accepted and understood by the taxpayers.

In arriving at their conclusions in the *Tillotson* case, the Board and the Circuit Court for the Sixth Circuit seem to have assumed that Congress intended to exercise its taxing power to the utmost. Reliance was placed upon certain statements contained in the Reports of the House and Senate of the 67th Congress while deliberating the bill which became the Revenue Act of 1921, which are claimed to indicate that the change in the existing law was being made by reason of the decision of the Supreme Court in the

Eisner v. *Macomber* case. (House Reports No. 350, 67th Congress, First Session, page 8; Senate Reports No. 275, 67th Congress, First Session, page 9.) Reliance upon these reports is not permissible, in view of the clear and certain language of the statute. In the recent case of *Helvering* v. *City Bank Farmers Trust Co.* (Vol. 80—No. 1, p. 1, Law ed. Advance Opinions), Mr. Justice ROBERTS said:

> "We are not at liberty to construe language so plain as to need no construction, or to refer to Committee reports where there can be no doubt of the meaning of the words used" (p. 3).

This Court, in the case of *Smietanka* v. *First Trust and Savings Bank,* 257 U. S. 602, speaking through Mr. Chief Justice TAFT, said:

> "There was indicated in the taxing Act the congressional intention to tax citizens everywhere, and non-citizens, resident in the United States, including persons, natural and corporate, on income from every source, less allowed deductions. But nowhere were words used which can be stretched to include unborn beneficiaries for whom income may be accumulating. *It may be that Congress had a general intention to tax all incomes, whether for the benefit of persons living or unborn, but a general intention of this kind must be carried into language which can be reasonably construed to effect it.* Otherwise the intention cannot be enforced by the courts. The provisions of such acts are not to be extended by implication" (Italics supplied) (pp. 605, 606).

Consideration, however, of other provisions of Sections 201 and 115 of the respective Acts establishes conclusively that Congress intended to exempt all stock dividends from taxation.

Coincident with the enactment of Section 201 (d) of the Revenue Act of 1921, exempting stock dividends from taxation, Congress directed in the same section of the statute that where a corporation proceeds to cancel or redeem stock distributed as a stock dividend at such a time and in such a manner as to make the cancellation or redemption essentially equivalent to the distribution of a taxable dividend, the amount so received shall be treated as a taxable dividend. This provision has been repeated in each of the succeeding Revenue Acts, the only change being that its application was extended in the Revenue Act of 1926 and subsequent Acts to include the cancellation or redemption of stock regardless of whether or not it was issued as a stock dividend (Section 201 (f), Revenue Act of 1924; Section 201 (g), Revenue Act of 1926; Section 115 (g), Revenue Acts of 1928, 1932 and 1934).

Clearly, therefore,—unless we accept the alternative that Congress intended to impose double taxation upon the issuance of a stock dividend and its subsequent redemption or retirement,—an inference always to be avoided (*Fort Smith Lumber Co.* v. *Arkansas,* 251 U. S. 532), we are forced to the conclusion that Congress, in enacting the Revenue Act of 1921 and each of the succeeding Acts, deliberately intended to exempt all stock dividends from the burden of taxation. We submit, therefore, that it is entirely immaterial whether Congress decided to exempt all stock dividends because it believed itself lacking in constitutional authority or for some other reason of public policy.

The successive reenactments of the statutory provision exempting a stock dividend from taxation are persuasive evidence of legislative approval of the administrative construction of such provisions.

Beginning with the Revenue Act of 1921, Congress has reenacted the statutory provision exempting a stock dividend from taxation in six consecutive Revenue Acts (Section 201 (d), Revenue Act of 1921; Section 201 (f), Revenue Acts of 1924 and 1926; Section 115 (f), Revenue Acts of 1928, 1932 and 1934).

The Treasury Department during this period of fourteen consecutive years has uniformly held in its official Regulations, Treasury Decisions and rulings that all stock dividends—that is, dividends paid by a corporation in its own stock—are entitled to the statutory exemption. (Articles 3 and 106, Regulations 33 (revised) (1918); Article 1545, Regulations 45 (1919); Article 1548, Regulations 62 (1922), 65 (1925) and 69 (1926); Article 628, Regulations 74 (1929) and 77 (1933); Article 115-8, Regulations 86 (1935). T. D. 3059, 3 C. B. 38 (1920); T. D. 3010, 3 C. B. 25 (1920); T. D. 3052, 3 C. B. 38 (1920); O. D. 732, 3 C. B. 39 (1920); O. D. 735, 3 C. B. 40 (1920); O. D. 859, 4 C. B. 24 (1921); O. D. 801, 4 C. B. 24 (1921); Solicitor's Opinion, 144, C. B. I-2, p. 4 (1922); A. R. R. 1127, C. B. I-2, p. 8 (1922); I. T. 1930 C. B. III-1, p. 39 (1924); T. D. 3553 and T. D. 3554, C. B. III-1, p. 38 (1924); I. T. 1900, C. B. III-1, p. 82 (1924); G. C. M. 916, C. B. VI-1, p. 135 (1927); I. T. 2449, C. B. VIII-1, p. 101 (1929); I. T. 2455, C. B. VIII-1, p. 218 (1929); G. C. M. 6709, C. B. VIII-2, p. 132 (1929); I. T. 2538, C. B. IX-1, 144 (1930).

The decision in I. T. 2538 (1930) is of particular importance because it involves substantially similar facts as were present in the *Tillotson* and instant cases—a common stock

dividend on preferred stock. The opinion contained in G. C. M. 6709 (1929) also is of importance because the situation there considered was the same as in the *Torrens* and *Gowran* cases.

It is a well established rule of statutory construction frequently relied upon by this Court in the interpretation of a taxing statute, that the administrative construction of a statute receives explicit sanction and approval by the repeated reenactments of the statute without change or modification. In *National Lead Co.* v. *United States*, 252 U. S. 140, this Court declared this principle as follows:

> "During all the intervening twenty-four years this rule of the Department with respect to drawbacks had been widely applied to many articles of much greater importance than linseed or its derivatives, and the practice was continued, linseed included after 1894, until the petition in this case was filed. The reenacting of the drawback provision four times, without substantial change, while this method of determining what should be paid under it was being constantly employed, amounts to an implied legislative recognition and approval of the executive construction of the statute (*United States* v. *Philbrick*, supra; *United States* v. *Falk*, 204 U. S. 143, 152, 51 L. ed. 411, 414, 27 Sup. Ct. Rep. 191; *United States* v. *Cerecedo Hermanos y Compania*, 209 U. S. 337, 52 L. ed. 821, 28 Sup. Ct. Rep. 532), for Congress is presumed to have legislated with knowledge of such an established usage of an executive department of the government (*United States* v. *Bailey*, 9 Pet. 238, 256, 9 L. ed. 113, 120)" (pp. 146, 147).

Again, in *Brewster* v. *Gage*, 280 U. S. 327, this Court expressed its opinion in the following forceful language:

> "The substantial re-enactment in later acts of the provision theretofore construed by the department is persuasive evidence of legislative approval of the

> regulation. * * * The subsequent legislation confirmed and carried forward the policy evidenced by the earlier enactments as interpreted in the regulations promulgated under them" (p. 337).

In *United States* v. *Cerecedo Hermanos y Compania*, 209 U. S. 337, the Court unequivocally stated this rule:

> "We have said that, when the meaning of a statute is doubtful, great weight should be given to the construction placed upon it by the department charged with its execution. * * * And we have decided that the re-enactment by Congress, without change, of a statute which had previously received long-continued executive construction, is an adoption by Congress of such construction" (p. 339).

See also *Old Mission Portland Cement Co.* v. *Helvering*, 293 U. S. 289; *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459; *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488; *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299; *Massachusetts Mutual Life Insurance Co.* v. *United States*, 288 U. S. 269; *Ramsey* v. *Commissioner*, 66 Fed. (2d) 316.

A case of particular importance because it reverses a decision of the Board which modified the consistent and uniform treatment of worthless debts on the part of the Treasury Department is *Commonwealth Commercial State Bank* v. *Lucas*, 41 F. (2d) 111. In its opinion, the Court of Appeals for the District of Columbia said:

> "In the present case, the contemporaneous and continued interpretation by the Treasury Department was both equitable and reasonable, and apparently met with the approval of Congress, as otherwise we must assume there would have been a change in the wording of the statute. There is no cogent reason for now adopting the more technical interpretation which the Board has placed upon the statute" (p. 113).

The administrative construction of a statute is entitled to great weight.

As we have seen, the official Regulations of the Treasury Department, the rulings known as Treasury Decisions, Office Decisions, Solicitor's Opinions, Income Tax Rulings and General Counsel's Memoranda, all officially published with the endorsement of the Treasury Department, have uniformly and unqualifiedly granted exemption to all dividends paid by a corporation in its own stock, irrespective of whether the dividend was paid in common stock on preferred stock, or in preferred stock on common stock, whether or not there was outstanding other preferred stock of the same preference and classification as the dividend stock.

This Court has frequently held that, if a statute is challenged as ambiguous or uncertain, the contemporaneous administrative interpretation will be held effective unless it is inconsistent with the statute, or leads to an unreasonable and absurd result. This rule is well expressed by Mr. Justice ROBERTS in the recent case of *Fawcus Machine Co.* v. *United States*, 282 U. S. 375, in the following language:

> "The regulations were made pursuant to express authority (see Sec. 1309 of the Revenue Act of 1918). They are valid unless unreasonable or inconsistent with the statute. *United States* v. *Grimaud*, 220 U. S. 506, 517, 518, 55 L. ed. 563, 567, 568, 31 S. Ct. 480; *International R. Co.* v. *Davidson*, 257 U. S. 506, 514, 66 L. ed. 341, 346, 42 S. Ct. 179. They constitute contemporaneous construction by those charged with the administration of the act, are for that reason entitled to respectful consideration, and will not be overruled except for weighty reasons. *United States* v. *Moore*, 95 U. S. 760, 763, 24 L. ed. 588, 589; *Brewster* v. *Gage*, 280 U. S. 327, 336, 74 L. ed. 457, 462, 50 S. Ct. 115" (p. 378).

In *Brewster* v. *Gage, supra,* this Court again declared this principle in unmistakable language. The Court said:

> "These regulations were prepared by the department charged with the duty of enforcing the acts. The rule so established is reasonable and does no violence to the letter or spirit of the provisions construed. A reversal of that construction would be likely to produce inconvenience and result in inequality. It is the settled rule that the practical interpretation of an ambiguous or doubtful statute that has been acted upon by officials charged with its administration will not be disturbed except for weighty reasons" (p. 336).

See also *Maryland Casualty Co.* v. *United States,* 251 U. S. 342.

Conclusion.

The decision of the Circuit Court for the Ninth Circuit, below, is correct and should be affirmed.

Respectfully submitted,

ROGER S. BALDWIN,
Amicus Curiae.

Dated April 25, 1936.

SUPREME COURT OF THE UNITED STATES.

No. 774.—October Term, 1935.

Corinne S. Koshland, Petitioner, vs. Guy T. Helvering, Commissioner of Internal Revenue. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[May 18, 1936.]

Mr. Justice Roberts delivered the opinion of the Court.

The writ of certiorari was granted in this case to resolve a conflict between the decision below[1] and one by the Circuit Court of Appeals for the Sixth Circuit.[2]

The question is whether, under the Revenue Acts of 1926 and 1928, a taxpayer who purchases cumulative non-voting preferred shares of a corporation upon which a dividend is subsequently paid in common voting shares, must, upon a sale or other disposition of the preferred shares, apportion their cost between preferred and common for the purpose of determining gain or loss.

The petitioner, in 1924 and 1926, purchased preferred stock of Columbia Steel Corporation. The company's articles of incorporation provided that holders of preferred stock should receive annual dividends of seven dollars a share in cash or, at the company's option, one share of common stock for each share of preferred. Dividends on the preferred were to be paid in full before any could be paid on the common; the common had voting rights, the preferred none. The preferred was redeemable at $105 per share, plus accrued dividends; and upon dissolution or liquidation was entitled to preferential payment of $100 per share, plus accrued dividends, and no more. The common alone was entitled in such event to the assets of the corporation remaining after payment of the preferred.

In each of the years 1925 to 1928, inclusive, the company had a surplus sufficient to pay the preferred dividends in cash, but elected to pay them in common stock. The petitioner received, in

[1] *Commissioner* v. *Koshland*, 81 F. (2d) 641.

[2] *Commissioner* v. *Tillotson Mfg. Co.*, 76 F. (2d) 189.

each of those years, shares of common stock as dividends on her preferred. In 1930 the corporation redeemed its preferred stock at $105 per share. In computing the profit realized by the petitioner the Commissioner allocated to the common stock so received, in each instance, a proportionate amount of the cost of the preferred stock. He thereby decreased the resulting cost basis per share and increased the gain. The Board of Tax Appeals reversed holding that the dividends were taxable income, were not stock dividends within the meaning of the Revenue Acts,[3] and their receipt did not reduce the cost basis of the preferred stock. The Circuit Court of Appeals reversed the Board and approved the Commissioner's action.

The petitioner contends, first, that the dividends she received were not stock dividends exempted from taxation by the revenue acts; and, secondly, if exempted, they were none the less income and cannot be treated as returns of capital in computing capital gain or loss. The respondent answers that the distributions were stock dividends because made in the capital stock of the corporation and come within the plain meaning of the provisions exempting stock dividends from income tax; accordingly, the Treasury regulations have consistently and continuously treated them as returns of capital, and required the original cost to be apportioned between the shares originally acquired and those distributed as dividends to obtain the cost basis for the calculation of gain or loss. We hold that the dividends were income and may not be treated as returns of capital.

The Revenue Act of 1913 imposed an income tax on dividends.[4] In *Towne* v. *Eisner,* 245 U. S. 418, it was held that where a corporation declared a dividend on its common stock, in the form of common stock, the dividend was not income within the intendment of the act. The Revenue Act of 1916 provided that a stock dividend should be considered income to the amount of its cash value.[5] In *Eisner* v. *Macomber,* 252 U. S. 189, it was decided that a dividend in the corporation's common stock paid to the then common stockholders, was not income within the meaning of the Sixteenth Amendment and therefore the effort to tax such dividends exceeded the power granted by the Amendment. It was said that such a

[3] Revenue Act of 1928, Section 115 (f), c. 852, 45 Stat. 791, 822; Revenue Act of 1926, Section 201 (f), c. 27, 44 Stat. 9, 11: "A stock dividend shall not be subject to tax."

[4] 38 Stat. 114, 166, 167.

[5] 39 Stat. 756, 757. Compare Revenue Act of 1918, 40 Stat. 1057, 1059.

dividend was not income because, by its payment, no severance of corporate assets was accomplished and the preexisting proportionate interests of the stockholders remained unaltered. After the decision the Treasury revoked regulations to the effect that a dividend paid in the corporation's stock is income and issued amended regulations, broadly phrased, to exempt all income in the form of stock dividends, whether the dividend shares be of the same class as those theretofore held by the stockholder or of a different class, and prescribing the method of allocating the original cost as between the old and the new stock for purposes of calculating gain or loss upon realization. Subsequently Congress adopted the Revenue Act of 1921 which provided, in Section 201 (d): "A stock dividend shall not be subject to tax . . ."[6] The reason for the exemption was the decision in *Eisner* v. *Macomber, supra.* The reports of both the House and the Senate Committees dealing with the bill state that the act "modifies the definition of dividends in existing law by exempting stock dividends from the income tax, as required by the decision of the Supreme Court in *Eisner* v. *Macomber* (252 U. S. 189)."[7]

Although *Eisner* v. *Macomber* affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, the Treasury gave the decision a broader interpretation which Congress followed in the Act of 1921. Soon after the passage of that Act, this court pointed out the distinction between a stock dividend which worked no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and such a dividend where there had either been changes of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the stockholder after the distribution was essentially different from his former interest.[8] Nevertheless the successive statutes and Treasury regulations respecting taxation

[6] 42 Stat. 227, 228. The same provision was repeated in all subsequent revenue acts; Revenue Acts of 1924 and 1926, § 201 (f); Revenue Acts of 1928, 1932 and 1934, § 115 (f).

[7] H. R. 350, 67th Cong., 1st Sess., p. 8. Senate Report No. 275, 67th Cong., 1st Sess., p. 9.

[8] *United States* v. *Phellis*, 257 U. S. 156; *Rockefeller* v. *United States*, 257 U. S. 176; *Cullinan* v. *Walker*, 262 U. S. 134; *Marr* v. *United States*, 268 U. S. 536.

of stock dividends remained unaltered.[9] We give great weight to an administrative interpretation long and consistently followed, particularly when the Congress, presumably with that construction in mind, has reenacted the statute without change.[10] The question here, however, is not merely of our adopting the administrative construction but whether it should be adopted if in effect it converts an income tax into a capital levy.

We are dealing solely with an income tax act. Under our decisions the payment of a dividend of new common shares, conferring no different rights or interests than did the old,—the new certificates, plus the old, representing the same proportionate interest in the net assets of the corporation as did the old,—does not constitute the receipt of income by the stockholder. On the other hand, where a stock dividend gives the stockholder an interest different from that which his former stock holdings represented he receives income. The latter type of dividend is taxable as income under the Sixteenth Amendment. Whether Congress has taxed it as of the time of its receipt, is immaterial for present purposes.

The relevant capital gains provisions of the Revenue Act of 1928 are Section 111 (a):

"... the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in Section 113" . . .[11]

and Section 113:

"The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property;" . . . (with exceptions having no relevancy here).[12]

The property disposed of was the petitioner's preferred stock. In plain terms the statute directs the subtraction of its cost from the proceeds of its redemption, if the latter sum be the greater. But we are told that Treasury Regulations[13] long in force require an allocation of the original cost between the preferred stock pur-

[9] See Regulations 65 and 69, Articles 1547, 1548; Regulations 74 and 77, Articles 627, 628; Regulations 86, Articles 115-7, 115-8.

[10] *Poe* v. *Seaborn*, 282 U. S. 101, 116; *McCaughn* v. *Hershey*, 283 U. S. 488, 492; *McFeely* v. *Commissioner*, 296 U. S. 102, 108.

[11] 45 Stat. 815.

[12] 45 Stat. 818.

[13] Regulations 74, Articles 58, 628, and 600.

chased and the common stock received as dividend. And it is said that while no provision of the statute authorizes a specific regulation respecting this matter, the general power conferred by the law to make appropriate regulations comprehends the subject. Where the act uses ambiguous terms, or is of doubtful construction, a clarifying regulation or one indicating the method of its application to specific cases not only is permissible but is to be given great weight by the courts. And the same principle governs where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations appropriate to its enforcement. But where, as in this case, the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation.[14] Congress having clearly and specifically declared that in taxing income arising from capital gain the cost of the asset disposed of shall be the measure of the income, the Secretary of the Treasury is without power by regulatory amendment to add a provision that income derived from the capital asset shall be used to reduce cost.

The judgment is

Reversed.

Mr. Justice STONE and Mr. Justice CARDOZO are of the opinion that the judgment should be affirmed.

The meaning of the Act of Congress exempting stock dividends from taxation as income at the time of distribution has had a practical construction through administrative action and legislative acquiescence. Even though the meaning may have been uncertain in the beginning, it has now become fixed in accordance with long continued practice. *Morrissey* v. *Commissioner*, 296 U. S. 344, 355; *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378, 384. This is not denied in the opinion of the court. Congress did not intend, however, when it refused to tax the newy acquired shares as income *in praesenti* to exclude them from taxation *in futuro* if disposed

[14] *Manhattan General Equipment Company* v. *Commissioner of Internal Revenue*, No. 226, October Term, 1935, and cases cited.

of at a profit. A tax upon a gainful use either of capital or of income, when the gain is fully realized, is a true tax upon income and not a capital levy. The question is merely one as to how the profit shall be computed. Following the analogy of *Miles* v. *Safe Deposit & Trust Company of Baltimore*, 259 U. S. 247, 253, the cost of all the shares is properly distributed between the investment and its accretions, between the old shares and the new. The Regulations so provide. Regulations 45, 1916 Act, Article 1547; Regulations 65, 1924 Act, Articles 1547 and 1548; Regulations 69, 1926 Act, Articles 1547 and 1548; Regulations 74, 1928 Act, Articles 627 and 628; Regulations 77, 1932 Act, Articles 627 and 628; Regulations 86, 1934 Act, Articles 115-7 and 115-8.

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1935

No. 774

CORINNE S. KOSHLAND, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED FEBRUARY 25, 1936.

CERTIORARI GRANTED MARCH 30, 1936.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 774

CORINNE S. KOSHLAND, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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APPEARANCES

For Taxpayer:
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For Comm'r.:
H. D. THOMAS, Esq.,
E. M. WOOLF, Esq.

Docket No. 70917

CORINNE S. KOSHLAND,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

DOCKET ENTRIES

1933

Apr. 5—Petition received and filed Taxpayer notified. (Fee paid)

" 5—Copy of petition served on General Counsel.

Jun. 2—Answer filed by General Counsel.

" 10—Copy of answer served on taxpayer. Circuit Calendar in the vicinity of San Francisco, California.

Jul. 17—Hearing set week of 9/11/33 at San Francisco, California.

Sep. 18—Hearing had before Mr. Leech. Submitted on the merits. Stipulation of facts read into the record. Briefs due Nov. 28, 1933. No exchange.

1933

Oct. 11—Transcript of hearing of 9/18/33 filed.

Nov. 27—Brief and proposed findings of fact filed by taxpayer.

" 27—Brief filed by General Counsel.

1934

Feb. 24—Supplemental brief filed by taxpayer.

Mar. 31—Memorandum opinion rendered, J. R. Leech, Div. 6. Judgment will be entered under Rule 50.

Apr. 16—Notice of settlement filed by taxpayer. 4/18/34 copy served.

" 17—Hearing set May 9, 1934.

" 26—Notice of settlement filed by General Counsel. copy served 4/28/34.

May 9—Hearing had before Mr. J. J. Marquette, Div. 1 on settlement under Rule 50—not contested—referred to Mr. Leech for decision.

" 14—Decision entered J. R. Leech, Div. 6.

Aug. 2—Petition for review by U. S. Circuit Court of Appeals (9) with assignments of error filed by General Counsel.

" 24—Proof of service filed by General Counsel.

Oct. 1—Motion for extension to Dec. 1, 1934 to complete and transmit record filed by General Counsel.

" 1—Order enlarging time to Dec. 1, 1934 to prepare evidence and deliver record entered.

Nov. 9—Motion re statement of evidence filed by General Counsel. Granted 11/15/34 and set for hearing 11/28/34.

1934

Nov. 9—Statement of evidence lodged.

" 9—Praecipe filed. Proof of service thereon.

" 26—Motion for extension to Feb. 1, 1935 to complete and transmit record filed by General Counsel.

" 26—Order enlarging time to Feb. 1, 1935 for preparation of evidence and delivery of record entered.

" 28—Hearing had before Mr. Leech on approval of statement of evidence. Continued to Nov. 30, 1934.

" 28—Order of continuance to Nov. 30, 1934 on approval of statement of evidence entered. [1*]

Nov. 30—Hearing had before Mr. Leech on approval of statement of evidence. C. A. V.

Dec. 1—Transcript of hearing of Nov. 30, 1934 filed.

" 4—Order that statement of evidence, submitted by Commissioner, be approved entered.

" 4—Statement of evidence approved and ordered filed. [2]

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*Page numbering appearing at the foot of page of original certified Transcript of Record.

United States Board of Tax Appeals

Docket No. 70917

CORINNE S. KOSHLAND,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION.

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:AR:E-2-MM R-60D) dated March 11, 1933, and as the basis of her proceedings, alleges as follows:

I.

The petitioner is an individual, with her address and residence at 3800 Washington Street, San Francisco, California. In the notice of deficiency hereinafter referred to, petitioner is erroneously designated as "Corrine S. Koshland".

II.

The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the taxpayer on March 11, 1933. The report of the Internal Revenue Agent in charge at San Francisco, California, dated September 15, 1932, was approved in said notice of deficiency and made a part thereof and accordingly, a copy of said report is attached and marked Exhibit "B".

III.

The taxes in controversy are income taxes for the [3] calendar year 1930 and for $833.48.

IV.

The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) Respondent erroneously determined that the exchange made by petitioner in 1929 to and with Transamerica Corporation, a Delaware corporation doing business in California, (hereinafter referred to as "Transamerica") of 32 shares of the capital stock of Bank of America, N. A., a national banking corporation (hereinafter referred to as "Bank") for 48 shares of the capital stock of Transamerica was a taxable transaction, when in truth and in fact this transaction was a non-taxable one, being an exchange made in connection with a reorganization as that term is defined in Section 112 of the Revenue Act of 1928. Accordingly, respondent erroneously fixed as the cost basis of said 48 shares of Transamerica the fair market value of said shares at the time of such exchange, instead of fixing as the cost basis of said shares of stock the cost basis of the 32 shares of stock of said bank.

(b) Respondent erroneously determined the cost basis and consequent profit to taxpayer in connection with the redemption during the year 1930 of 165 shares of preferred stock of Columbia Steel Corporation. In this behalf, petitioner alleges that respondent determined that the cost basis to petitioner of said 165 shares of preferred stock was the

sum of $11,505.80, whereas the correct cost basis of said shares of stock was and is $16,500.00. [4]

V.

The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) On April 18, 1928, petitioner purchased 20 shares of stock of Bank of America, N. A. at a price of $225.00 per share, or a total sum of $4500.00. In January, 1929, taxpayer, as the owner of certain shares of stock of Bank of Italy, received as a dividend thereon 12 shares of stock of Bank of America, N. A., and the market value of said 12 shares of stock of Bank of America, N. A., at date of receipt and therefore the cost basis of petitioner of said 12 shares of stock was $2316.00. The total cost to petitioner of said 32 shares of stock of Bank of America, N. A., was $6816.00. During the year 1929, taxpayer, in connection with a tax free reorganization as defined in the Revenue Act of 1928, exchanged said 32 shares of stock of Bank of America, N. A., for 48 shares of stock of Transamerica Corporation, and the proper cost basis to petitioner of said 48 shares of stock of Transamerica Corporation is the sum of $6816.00. During the year 1930 taxpayer sold said 48 shares of stock of Transamerica Corporation and in computing the gain or loss to petitioner with respect to said 48 shares of stock of Transamerica Corporation, respondent erroneously used as the cost basis thereof the sum of $6276.00, instead of the sum of $6816.00.

(b) On February 28, 1924, petitioner purchased 150 shares of preferred stock of Columbia Steel Corporation for the sum of $100.00 per share, or a total amount of $15,000.00. [5]

On March 2, 1926, petitioner purchased from said corporation 15 shares of its preferred stock for the sum of $100.00, per share, or a total amount of $1500.00.

That, pursuant to the Articles of Incorporation of said Columbia Steel Corporation during all of the times herein referred to, said shares of preferred stock were non-voting (the entire voting *rites* being vested in the shares of common stock) and had a par value of $100.00 per share and were redeemable at any time after five years from the date of incorporation at a price of $105.00 per share, plus all accumulated dividends. That Article IV of the Articles of Incorporation of said Columbia Steel Corporation at all of the times herein mentioned read as follows, insofar as appertained to the payment of dividends on said shares of preferred stock:

> "The holders of record of the shares of the preferred stock are entitled to receive dividends from and after the respective dates of issuance of such shares before any dividend shall be paid upon or set apart for the common stock as follows:
>
> At the rate of 7% per annum if the Board of Directors shall decide to pay such dividends in cash and at the rate of one share of common stock per annum on each share of preferred

stock if the Board of Directors shall have determined to pay such dividends in common stock of the corporation. Such preferred stock dividends shall be payable in semi-annual instalments on the 1st day of January and on the 1st day of July of each year. The dividends upon all of the preferred stock are cumulative, so that if any one year dividends shall not have been paid thereon, either at the rate of 7% per annum in cash or one share of common stock per annum on each share of preferred stock, the deficiency shall be paid either in cash or in stock, as aforesaid, before any dividends shall be paid upon or set apart for the common stock, and in the event of any liquidation or dissolution or winding up of the corporation, the holders of record of all the shares of the preferred stock shall be entitled, before any distribution shall be made to the holders of the common stock irrespective of the amount available to the holders of the common stock, to be paid in full the par value of [6] such shares of preferred stock, and also an amount found by deducting, from a sum equal to 7% per annum on the par value of the preferred stock from the respective dates of issuance to the date of distribution, the aggregate of the dividends which shall have been paid in cash or in common stock, computing said common stock for this purpose at $7.00 per share; and, after the payment of the amounts hereinabove specified to the holders

of record of the shares of the preferred stock they shall not be entiltled to any share or portion of the assets of the corporation. No dividends accruing after five years from the date of incorporation of this corporation on the preferred stock shall be paid in common stock."

Pursuant to the provisions of said Article IV, said corporation declared and paid in January, 1925, to the holders of record of the prefered stock of said corporation on December 31, 1924, a dividend at the rate of one share of common stock per annum on each share of preferred stock issued and outstanding during the year 1924, and declared and paid in January, 1926, to the holders of record of the preferred stock of said corporation on December 31, 1925, a dividend at the rate of one share of common stock per annum on each share of preferred stock issued and outstanding during the year 1925, and declared and paid in January, 1927, to the holders of record of the preferred stock of said corporation on December 31, 1926, a dividend at the rate of one share of common stock per annum on each share of preferred stock issued and outstanding during the year 1926, and declared and paid in July, 1927, to the holders of record of the preferred stock of said corporation on June 30, 1927, a dividend at the rate of half of a share of common stock on each share of preferred stock issued and outstanding during the half year period ending June 30, 1927.

Petitioner, as the owner of 150 shares of pre- [7] ferred stock of Columbia Steel Corporation, received

in January, 1925, 127 shares of common stock of said Columbia Steel Corporation, in payment of said cumulative annual dividend on shares of preferred stock for the year 1924, and the market value of each share of such common stock at date of such receipt was $6.50, and the cost basis to petitioner of each share of common stock received as aforesaid was not less than $6.50. Petitioner, as the owner of 150 shares of preferred stock of Columbia Steel Corporation, received in January, 1926, 150 shares of common stock of said Columbia Steel Corporation, in payment of said cumulative annual dividend on shares of preferred stock for the year 1925, and the market value of each share of such common stock at date of such receipt was $6.25, and the cost basis to petitioner of each share of common stock received as aforesaid was not less than $6.25. Petitioner, as the owner of 165 shares of preferred stock of Columbia Steel Corporation, received in January, 1927, 165 shares of common stock of said Columbia Steel Corporation, in payment of said cumulative annual dividend on shares of preferred stock for the year 1926, and the market value of each share of such common stock at the date of such receipt was $7.00, and the cost basis to petitioner of each share of common stock received as aforesaid was not less than $7.00. Petitioner, as the owner of 165 shares of preferred stock of Columbia Steel Corporation, received in July, 1927, 82½ shares of common stock of said Columbia Steel Corporation, in payment of said cumulative semi-annual dividend on shares of

preferred stock for the first half of the year 1927, and the market value [8] of each share of such common stock at date of such receipt was $7.00, and the cost basis to petitioner of each share of common stock received as aforesaid was not less than $7.00. In this behalf, petitioner sets forth that none of said shares of common stock received as aforesaid constituted a stock dividend. In this behalf, petitioner further sets forth that the exercise of the election on the part of said Columbia Steel Corporation to pay said cumulative preferred dividend in the form of common stock constituted an agreement between petitioner and said corporation whereby petitioner received $7.00 in cash as such cumulative annual dividend on each share of preferred stock held by her and used said $7.00 in cash for the contemporaneous purchase of one share of common stock from said corporation. This is confirmed by the recordance on the books of the Columbia Steel Corporation of a distribution of surplus to the preferred stockholders equivalent to $7.00 per share per annum and the corresponding increase of common stock outstanding.

Petitioner sets forth that the cost basis of the 165 shares of preferred stock of Columbia Steel Corporation acquired by her, as aforesaid is the sum of $16,500.00, and that such cost basis should not be reduced by the sum of $693.02 (representing the cost basis erroneously allocated to 127 shares of common stock received as a dividend in 1925), nor should said cost basis be reduced in the sum of

$1,108.62 (representing the cost basis erroneously allocated to 150 shares of common stock received as a dividend in 1926), nor should said cost basis be reduced in the sum of $1,129.71 (representing the cost basis erroneously allocated to 165 shares of common stock received [9] as a dividend in January, 1927); nor should said cost basis be reduced in the sum of $558.96 (representing the cost basis erroneously allocated to 82½ shares of common stock received as a dividend in July, 1927). In January, 1930, said 165 shares of preferred stock of Columbia Steel Corporation were redeemed for the sum of $17,325.00, and by reason thereof, petitioner realized a profit of $825.00, and no more.

VI.

During the year 1931, petitioner paid to the Collector of Internal Revenue at San Francisco, California, the sum of $1388.06, as and for income taxes for the calendar year 1930.

WHEREFORE, petitioner prays that this Board may hear the proceeding and determine that there is no deficiency in income taxes herein, and for such other relief as may be meet and proper in the premises.

JOHN C. ALTMAN
B. H. HICKLIN, C.P.A.
Counsel for Petitioner.
615 Russ Building,
San Francisco, Calif. [10]

State of California,
City and County of San Francisco.—ss.

CORINNE S. KOSHLAND, being duly sworn, says: That she is the petitioner named in the foregoing petition and is familiar with the statements therein contained and that the facts therein stated are true.

CORINNE S. KOSHLAND

Subscribed and sworn to before me this 31st day of March, 1933.

[Seal] LOUIS WIENER
Notary Public in and for the City and County of San Francisco, State of California. [11]

EXHIBIT "A"

NP-2-28

TREASURY DEPARTMENT
Washington

Mar 11, 1933

Office of
Commissioner of Internal Revenue
Address Reply to
Commissioner of Internal Revenue
And Refer to
Mrs. Corrine S. Koshland,
3800 Washington Street,
San Francisco, California.

Madam:

You are advised that the determination of your tax liability for the year 1930 discloses a deficiency of $833.48, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the inclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this form will expedite the closing of your return by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the inclosed form, or on the date assessment is made, whichever is earlier; WHEREAS IF THIS FORM IS NOT FILED, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNET,

Commissioner

By W. T. SHERWOOD,

Acting Deputy Commissioner

Inclosures:

Statement

Form 870 [12]

STATEMENT

IT:AR:E-2
MMR-60D

In re: Mrs. Corrine S. Koshland
3800 Washington Street,
San Francisco, California

Income Tax Liability

Year—1930
Income Tax Liability—$2,221.54
Income Tax Assessed—$1,388.06
Deficiency—$833.48

The report of the internal revenue agent in charge at San Francisco, California, a copy of which was furnished you, is approved and is hereby made a part of this letter.

Careful consideration has been accorded your protest dated November 1, 1932, in connection with the findings of the examining officer, and the information submitted at a conference held in the office of the internal revenue agent in charge. [13]

EXHIBIT "B"

TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE

San Francisco, Calif.

In re: Income Tax
Date of report: Sep. 15, 1932

Corinne S. Koshland,
3800 Washington St.,
San Francisco, Calif.

Years—1930
Additional Tax—$833.48
Overassessment—
Penalties—
Total—

The recommendations which this office proposes to make with respect to your income tax liability as the result of a recent examination by an internal revenue agent are shown in the statement attached.

If you acquiesce in the proposed tax liability the inclosed Form 870 should be executed and forwarded to this office. Your consent on Form 870 to the prompt assessment of any deficiency indicated will stop the running of interest to be assessed on such deficiency under the provisions of section 283(d) of the Revenue Act of 1926 or section 292 of the Revenue Act of 1928, upon a date not later than thirty days after the filing of Form 870 properly executed. Unless such consent is filed the interest to be assessed under the law upon any deficiency indicated runs to the date the deficiency is

assessed and the assessment may be made only as provided by Section 274(a) of the Revenue Act of 1926 and/or section 272(a) of the Revenue Act of 1928.

Should you desire to make immediate payment without awaiting formal assessment and notice and demand, you should communicate with the collector of internal revenue at Custom House, San Francisco, inclosing this letter, or a copy thereof. If payment is so made the interest period will terminate on the date of payment.

If you do not acquiesce in the proposed recommendations you should file a protest in writing with this office within 20 days from the date of this letter. Any protest so filed will be given careful consideration, and, if you so desire, you will be given an opportunity for a hearing before the recommendations are forwarded to Washington.

Arrangements will be made by this office upon your request to answer any questions which may occur to you in your review of these recommendations.

In any event please sign the inclosed form acknowledging receipt of this letter and related papers and return such form to this office.

Respectfully,

B. W. WILDE, JR.,
Internal Revenue Agent in Charge.

Inclosures:

Statement of adjustments
Form 870
Form of acknowledgment. [14]

Name Corinne S. Koshland

STATEMENT OF TOTAL TAX LIABILITY

Year—1930

Tax Previously Assessed—$1,388.06

Adjustments proposed in Accompanying Report

Deficiency—$833.48

Overassessment—None

Correct Tax Liability—$2,221.54

Totals— [15]

Preliminary Statement

Taxpayer: Corinne S. Koshland

Examining Officer: M. Surryhne

Table of Contents

Schedule 1, Block Adjustments

2, Computation of Tax

Exhibit A, Cost of Transamerica

B, do of Columbia Steel

Principal cause of additional tax: Adjustment of cost of Transamerica and of Columbia Steel.

All changes were discussed with Mr. Redman, who does not concede the method of adjusting cost of Columbia Steel.

Taxpayer: Single, with no dependents.

Related cases: None [16]

Corinne S. Koshland

Schedule 1
Block Adjustments

	Return	Additions	Deductions	Corrected
3. Interest	3,517.00	a. 219.44		3,736.44
4. " 2% paid	3,924.44		a. 219.44	3,705.00
7. Rents	28,110.79			28,110.79
8. Profit from Sales	(30,137.93)	b. 9,174.26		(20,963.67)
9. Lib. Bd. Int.	297.50			297.50
10. Dividends	59,641.46			59,641.46
11. Other Income	365.93			365.93
12. Total Income	$65,719.19			$74,893.45
13. Interest	16,989.42			16,989.42
14. Taxes	4,384.87			4,384.87
17. Contributions	6,470.39		c. 1,376.13	7,846.52
18. Other deductions	1,209.00			1,209.00
19. Total do	$29,053.68			$30,429.81
Total Income	$36,665.51	(9,393.20)	(1,595.57)	44,463.64

Schedule 1-a
Explanation of Items

a. Included on Line 4 is interest of $219.44, received on bonds at time of sale which is transferred to Line 3, as no tax was paid at source.

b. The cost of securities sold was overstated as follows:

Transamerica (See Exhibit A)	$8,380.06
Columbia Steel (do B)	794.20
Total	$ 9,174.26

c. The deduction for contributions is adjusted as follows:

Income reported	$36,665.51
Addition line 18	9,174.26
Contributions deducted	6,470.39
Total before deduction for contributions	$52,310.16
15% above	7,846.52
Amount deducted	6,470.39
Difference	$ 1,376.13

Corinne S. Koshland

Schedule 2

Year ended 12-31-30

Computation of Tax

Net income from schedule 1		44,463.64
Less: Dividends	$59,641.46	
Interest on Lib. Bonds, etc.	297.50	
Personal exemption and credit dependents	1,500.00	61,438.96
Balance subject to normal tax		None
Surtax on $44,463.64	2,295.64	
		2,295.64
Less: Credit for earned net income from schedule,	None	
Income tax paid at source	74.10	74.10
Total tax assessable		$ 2,221.54
Tax previously assessed		1,388.06
Additional tax to be assessed		$ 833.48

[18]

Corinne S. Koshland

Exhibit A

Cost of Transamerica

		Net cost	Shares sold 1930
		No.	Cost
Bank of Italy purchase	25	11,418.75	
do subn.	10	4,500.00	
rites		.90	
do purchase	40	21,640.00	
Exchanged for B. of I.	300	37,559.65	
Sk. Div.	75		
Subn.	62	11,160.00	
Exchanged for Transamerica			764¾ 48,719.65
Purchased do			¼ 31.25
Bancitaly purchased	10	850.00	
do subn.	22	2,200.00	
" rites		32.80	
" sk. div.	12.8		
" purchased	.2	18.	
" Sk. div.	6 3/7		
Sold	3/7	(26.04)	
Exchanged for Transamerica			51 3,076.74
Received in exchange for Bank of America 2-25-29			48 6,276.00
Market value $130.75			
Apr. 25, 1929 Sk. Div.			8
July 25, 1929 do.			8
Sept. 25, 1929 "			1,320
Oct. do			22
Jan. 1930 "			22
Total sold			2,244 58,103.64
Cost reported			66,483.70
Difference			$ 8,380.06

[19]

Corinne S. Koshland

Exhibit B

Cost of Columbia Steel Pfd.

		Com.		Pfd.	
		No.	Cost	No.	Cost
1 Feb. 28, 1924, pur for	$15,000	750	$ 825.00	150	14,175.
Jan. 31, 1925, Sk. Div. on pfd. in com.	4.889%	127	693.02		(693.02)
Jan. 30, 1926, Sk. Div. on pfd. incom.	8.223%	150	1,108.62		(1,108.62)
2. Mar. 2, 1926, pur for	$ 4,500	750	3,678.89	15	821.11
Feb. 1, 1927, Sk. Div. on pfd. incom.	8.562%	165	1,129.71		(1,129.71)
Jan. 31, 1928, Sk. Div. on pfd. incom.	4.632%	82½	558.96		(558.96)
Total cost pfd.				165	11,505.80
Cost reported					12,300.00
Difference					794.20
1. Cost allocated on basis of market	com.		1.10		
	pfd.		94.50		
2. do	com.		6.25 x 50	312.50	81,753%
	pfd.		69.75 x 1	69.75	18247%

3. The only common that is shown is that which effects the pfd.

[Endorsed]: Filed Apr. 5, 1933. [20]

[Title of Court and Cause.]

ANSWER.

The Commissioner of Internal Revenue by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits, denies and avers as follows:

I. Admits the allegations contained in paragraph I of the petition.

II. Admits the allegations contained in paragraph II of the petition.

III. Admits that the taxes in controversy are income taxes for the calendar year 1930. Denies that the amount in controversy is as alleged in paragraph III of the petition.

IV(a) & (b). Denies that the Commissioner erred as alleged in paragraph IV, sub-paragraphs (a) and (b), of the petition.

(c). Avers that in determining the net taxable income set up in Exhibit B of the petition the Commissioner allowed the sum of $7,846.52 (which sum represents 15% of the amount which the Commissioner determined to be petitioner's net income before deducting contributions) as a deduction on account of contributions, and that if the Board determines that petitioner's net income before deducting contributions is less than the amount determined by the Commissioner, the deduction for contributions should be reduced by 15% of such decrease. [21]

V(a). Admits that the petitioner was the owner of 32 shares of stock of Bank of America, N. A. Admits that prior to the year 1930 said shares of stock were exchanged for 48 shares of stock of Transamerica Corporation. Admits that during the year 1930 petitioner sold said 48 shares of stock of the Transamerica Corporation. Admits that in computing the gain or loss to petitioner with respect to said 48 shares of stock of said Transamerica Corporation the Commissioner used as the cost or other basis thereof the sum of $6,276.00. Avers that peti-

tioner is estopped from claiming a cost or other basis for said stock exceeding the sum of $4,500, in that if petitioner did receive in the year 1929 12 shares of said stock from the Bank of Italy as alleged in the petition the fair market value of said 12 shares of stock was not reported by the petitioner on her 1929 income tax return as a taxable dividend. Denies all other allegations contained in sub-paragraph (a) of paragraph V of the petition.

(b). Admits that in January 1930 165 shares of preferred stock of the Columbia Steel Corporation owned by the petitioner were redeemed for the sum of $17,325. Denies all other allegations contained in sub-paragraph (b) of paragraph V of the petition.

Avers that the petitioner is estopped from claiming a cost or other basis exceeding the sum of $11,505.80 for said 165 shares of preferred stock in that the alleged dividends of January 1925, January 1926, January 1927 and July 1927 were not reported as income on petitioner's 1925, 1926 and 1927 income tax returns. [22]

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the Board redetermine the deficiency for the calendar year 1930 to be equal to the amount determined by the Commissioner, viz. $833.48.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:

F. R. SHEARER,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: Jun. 2, 1933. [23]

[Title of Court and Cause.]

John C. Altman, Esq., for the petitioner.
H. D. Thomas, Esq., for the respondent.

MEMORANDUM OPINION.

LEECH: This proceeding seeks redetermination of a deficiency determined in the amount of $833.48 for the calendar year 1930. Two errors are assigned but one of these was abandoned by the petitioner on the hearing. The remaining issue presents the question of the cost basis, for determination of gain or loss upon the redemption in 1930 for $17,325, of 165 shares of preferred stock of the Columbia Steel Corporation, belonging to petitioner.

Petitioner is a resident of San Francisco, California. The Columbia Steel Corporation, a Delaware corporation, was organized in November, 1922, with an authorized capitalization of 100,000 shares of preferred stock of a par value of $100 per share, and 1,000,000 shares of no [24] par value common stock. Upon organization the corporation acquired, from W. E. Creed, certain properties in consideration of the issuance to him of 39,918.42 shares of its preferred and 547,500 shares of its common stock.

The additional preferred stock of the corporation was offered to the public at par and Creed offered to certain prospective purchasers of this preferred stock, five shares of his common stock for each share of preferred stock they might purchase from the corporation. Petitioner, under this offer, subscribed for 150 shares of preferred stock at par and paid the corporation the sum of $15,000. In subscribing for this stock petitioner understood that she was to receive 150 shares of preferred stock from the corporation and 750 shares of common stock from Creed. This common stock was issued petitioner as agreed upon.

The charter of the corporation authorized the payment of the 7 per cent dividends on the preferred stock, for the first five years of operation, in common stock of the corporation at the rate of one share for each share of preferred. Under this authority the directors declared dividends upon the preferred stock, payable in common stock at the prescribed rate, for the years 1925, 1926, 1927 and 1928. In each of these years the surplus of the corporation was in excess of a 7 per cent dividend upon the issued preferred stock, and, upon the issuance of common stock as a dividend, surplus was, in each instance, debited with an amount at the rate of $7.00 for each share of stock issued and the same amount credited to the common stock account.

In January, 1926, the corporation offered to its stockholders of record the right to subscribe for a specified number of shares of preferred and [25]

common stock in units of one share of preferred and 50 shares of common stock for a price of $300 per unit. Petitioner availed herself of this right and purchased from the corporation 15 units, consisting of 15 shares of preferred stock and 750 shares of common stock.

Petitioner, as the owner of shares of preferred stock of the corporation received shares of common stock representing dividends paid in common stock as follows:

January, 1925	127	shares	common	stock
January, 1926	150	"	"	"
January, 1927	165	"	"	"
January, 1928	82½	"	"	"

During the year 1930, petitioner received the sum of $17,325 in redemption of her 165 shares of preferred stock of the Columbia Steel Corporation. She did not report on her income tax returns for the years 1926 to 1928, inclusive, any amounts as representing the dividends received by her, in common stock of the corporation in those years.

Respondent, in determining the deficiency, appealed from, has treated the original acquisition by petitioner of 150 shares of preferred and 750 shares of common stock, as the purchase of these two blocks of stock for a consideration of $15,000, and has apportioned the sum, paid by petitioner, to the common as well as the preferred stock, on the basis of the relative fair market value of each at the time of acquisition. Respondent has also treated

the dividends received by petitioner in common stock as stock dividends, allocating to the common stock received, in each instance, a proportionate amount of the cost of the preferred stock upon which it was paid. This action has decreased the cost basis of the preferred stock and increased the profit resulting from its redemption. Respondent has also, in determining [26] a cost basis for the 15 shares of preferred stock purchased by petitioner in the exercise of her stock rights, as hereinbefore set out, allocated a proportionate amount of the total payment made for the united of preferred and common stock, to each such class of stock, on the basis of the fair market value of each class of stock at the time of purchase.

Petitioner does not contest the correctness of respondent's determination as to the values of the common stock at the time of the several transactions hereinbefore detailed. She contends that the 150 shares of preferred stock, originally acquired, had a cost basis of $15,000, the 750 shares of common stock received from Creed being in effect a gift, and, that the dividends received by her on her preferred stock, paid in common stock of the corporation, were the equivalent of cash dividends and, consequently, did not reduce the cost basis of the preferred stock. Petitioner urges further that the 15 shares of the preferred stock purchased by her in the exercise of her stock rights had a cost of $100 per share, as the total amount paid for each unit subscribed for should have been allocated, not upon the basis of

the market value of the two classes of stock acquired, but on the basis of $100 for each share of preferred, the balance being the cost of the common stock.

We think it clear that, irrespective of the fact that petitioner acquired her original 750 shares of common stock of the corporation from Creed, and although the total consideration paid by petitioner passed to the corporation, such consideration, in so far as petitioner is concerned, represents the consideration paid by her and therefore the cost to her of both the [27] preferred and common stock acquired. It is undoubtedly true that it was petitioner's intention to acquire 150 shares of preferred and 750 shares of common stock. The only payment was to the corporation but the result of the payment entitled her to receive the common as well as the preferred stock. She would not be entitled to the common stock unless she made such payment. The circumstances of the transaction show clearly that the transfer to her of these 750 shares of common stock by Creed was in no sense a gift, but was in consideration of the payment of $15,000 to the corporation. We think that respondent was correct in holding that, as to this petitioner, the payment made by her of $15,000, represented her cost of the two blocks of stock, common and preferred, which she was entitled to and did receive under the agreements made by her with the corporation and Creed.

The petitioner, in respect to the question of the dividends paid in common stock, relies upon the

Tilotson Manufacturing Co., 27 B. T. A. 913. Respondent attempts to differentiate this case on the facts established in the present record. He calls attention to the fact that the dividend paid in common stock was paid under authority of the charter of the corporation. We see no material distinction in that fact. Whether the action of the directors in paying the preferred dividend in common stock was taken under general or specific authority of the charter or under authority granted by the stockholders is immaterial. Respondent further calls attention to the fact that, under the charter of the corporation, the right existed in the holders of preferred stock to convert within a certain period of years, such [28] stock into common stock of the corporation at the rate of 10 shares of common for each share of preferred. He urges that this provision, in effect, makes the preferred stock merely a right to receive common stock and, therefore, not a distinct and separate type of security with rights different from those possessed by the common stock.

With this, we do not agree. Even though the right to convert the preferred stock into common stock existed, the exercise of this right was optional with the stockholder and, if not exercised, the preferred stock remained as such, with rights not possessed by the common stock and different also in that it lacked the voting rights pertaining to the common stock.

After a careful examination of the Tilotson case, supra, we are of the opinion that the question is

controlled by that case, as contended by petitioner, and that the dividends received in common stock did not constitute stock dividends representing the mere dilution of the stockholders' present interest, but were taxable dividends which did not serve to reduce the cost basis of the preferred stock upon which they were paid.

Respondent argues that petitioner is estopped to raise this question by reason of the fact that she has failed to include these dividends in income for the years in which paid. This contention is without merit. There is no indication of deception practiced nor any wrongful act by petitioner, upon which respondent relies, in so treating these dividends on preferred stock. The method with which petitioner treated these dividends in making her returns for the four years in question was the treatment approved by respondent in those years. C. B. IX-1, page 144; C. B. VIII-132. It [29] is clear that there is no ground for an estoppel of petitioner to raise the question here presented. Ohio Brass Co., 17 B. T. A. 1199; United States Trust Co., 13 B. T. A. 1074; Summerfield Co., 29 B. T. A. 77. Cf. Tidewater Oil Co., promulgated February 27, 1934.

In reference to the 15 shares of stock acquired by petitioner as parts of 15 units of preferred and common stock purchased at $300 per unit, it is clear, we think, that the unit cost must be allocated to the two stocks composing such unit, on the basis of the market value of each stock at the time acquired by petitioner, which is the basis used by respondent.

We are concerned with what petitioner received for the payment made by her and this is not controlled by the bookkeeping of the seller in its recording of her payment upon its books in the sum of $100 for each share of preferred stock and $4.00 per share of each share of common stock. The stock was purchased in units, one share of preferred and 50 shares of common. It was sold only in this way and, consequently, what petitioner received were two blocks of stock for a payment of $300 for each unit. Upon this point we sustain the respondent.

Enter:

Judgment will be entered under Rule 50.

[Seal]

[Endorsed]: Entered Mar. 31, 1934. [30]

United States Board of Tax Appeals

Docket No. 70917

CORINNE S. KOSHLAND,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION.

The parties hereto have, under Rule 50, each filed a notice of settlement accompanied by a recomputation of deficiency as in accord with the Memorandum Opinion entered herein March 31, 1934,

and the deficiency as recomputed by each being in the same amount and correct, it is hereby

ORDERED AND DECREED that for the calendar year 1930 there is a deficiency of $502.50

Enter:

[Seal] (Signed) J. RUSSELL LEECH
Member.

Washington, D. C.

[Endorsed]: Entered May 14, 1934. [31]

[Title of Court and Cause.]

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR.

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

NOW COMES, Guy T. Helvering, Commissioner of Internal Revenue, by his attorneys, Frank J. Wideman, Assistant Attorney General, Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, and Harold D. Thomas, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I.

Petitioner on review (hereinafter referred to as the Commissioner) is the duly appointed qualified and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States. The respondent on review is an individual residing in San Francisco,

California, and filed her Federal income tax return for the year 1930 involved herein with the Collector of Internal Revenue for the First District of California at San Francisco, California, and the office of said Collector is located within the judicial circuit of the United States Circuit Court of Appeals for the Ninth Circuit. [32]

II.

The nature of the controversy is as follows:

Respondent on review was the owner of 165 shares of preferred stock of the Columbia Steel Corporation, of which 150 shares had been acquired by her by purchase on February 28, 1924, and 15 shares by purchase on March 2, 1926. As the holder of preferred stock she received her pro rata share of common stock distributed by the corporation in each of the years 1925 to 1928 inclusive, as dividends on the preferred stock. During the taxable year 1930 she received $17,325.00 in redemption of her 165 shares of preferred stock. In determining the profit on the redemption the Commissioner reduced or diminished the original cost basis of such preferred shares by reason of the receipt of the shares of common stock as dividends thereon on the theory that such distributions of common stock were stock dividends, that the original investment is represented not only by the preferred shares but also by the common shares, and that the cost should be apportioned partly to the preferred and partly to the common shares with the result that only the amount apportioned to the preferred shares may be used in determining taxable profit on the redemption of the

latter. The apportionment was made on the basis of the respective values of the preferred stock and common stock at the time of receipt of the latter.

The Commissioner, pursuant to Section 272 of the Revenue Act of 1928, notified Corinne S. Koshland, respondent on review, of his determination of income tax liability for the year 1930 and the respondent on review duly filed a petition with the United States Board of Tax Appeals from the Commissioner's determination for said year. The proceeding was duly heard before the Board. The Board's opinion was promulgated on March 31, 1934, and its decision fixing the amount of tax liability pursuant to the opinion was [33] entered on May 14, 1934.

The Board decided that Corinne S. Koshland, the taxpayer, was entitled to use the original purchase price of the 165 shares as cost in determining profit on the redemption of said shares, while the Commissioner contends that such purchase price should be diminished by apportioning a part of same to the common stock received as dividends on the preferred stock. The aggregate amount which the Commissioner apportioned to the common stock and by which he reduced the original purchase price of the preferred stock was $3,490.31. There is no issue presented as to the amount or basis of apportionment, if apportionment is correct in principle. The Commissioner also contends that the taxpayer, Corinne S. Koshland, is estopped from claiming that no part of the original purchase price should

be apportioned to the common stock received by her by reason of her holdings of preferred stock.

III.

The said Commissioner's assignments of error are as follows:

1. The Board of Tax Appeals erred in holding and deciding that dividends in shares of common stock paid by Columbia Steel Corporation on its preferred stock did not constitute stock dividends.

2. The Board erred in not holding and deciding that dividends in shares of common stock paid by the Columbia Steel Corporation on its preferred stock constituted stock dividends.

3. The Board erred in holding and deciding that, in determining profit on the disposition by the taxpayer in 1930 of her 165 shares of preferred stock of the Columbia Steel Corporation, the cost basis of the preferred stock should not be reduced by reason of dividends thereon received by her in prior years in shares of common stock. [34]

4. The Board erred in not holding and deciding that, in determining profit on the disposition by taxpayer in 1930 of her 165 shares of preferred stock of the Columbia Steel Corporation, the cost basis of the preferred stock should be reduced by reason of dividends thereon received by her in prior years in shares of common stock.

5. The Board erred in failing to find that during the first five years of the existence of the Columbia Steel Corporation the holder of preferred stock

could convert such preferred stock into common stock at the rate of ten shares of common for each share of preferred.

6. The Board erred in holding and deciding that none of the original cost basis of taxpayer's preferred stock of the Columbia Steel Corporation should be allocated to the shares of common stock which she received in prior years as dividends on the preferred stock.

7. The Board erred in not holding and deciding that part of the original cost basis of taxpayer's preferred stock of the Columbia Steel Corporation should be allocated to the shares of common stock which she received in prior years as dividends on the preferred stock.

8. The Board erred in holding and deciding that petitioner was entitled to use a cost basis of shares of preferred stock undiminished by reason of the receipt in prior years of shares of common stock as dividends on preferred stock.

9. The Board erred in not holding and deciding that taxpayer was not entitled to use a cost basis of shares of preferred stock undiminished by reason of the receipt in prior years of shares of common stock as dividends on preferred stock. [35]

10. The Board erred in failing to find that the dividends on preferred stock paid in common stock were designated on the books of the Columbia Steel Corporation as stock dividends.

11. The Board erred in holding and deciding that the receipt by the taxpayer of shares of com-

mon stock of Columbia Steel Corporation by reason of her ownership of preferred shares does not affect the cost basis of the preferred shares in determining profit on the disposition of the latter.

12. The Board erred in not holding and deciding that the receipt by the taxpayer of shares of the Columbia Steel Corporation by reason of her ownership of preferred shares affects the cost basis of the preferred shares in determining profit on the disposition of the latter.

13. The Board erred in not holding and deciding that the taxpayer failed to prove that the distributions of common stock were not proportional redistributions of existing rights and interests of the stockholders.

14. The Board erred in holding and deciding that taxpayer was not estopped from claiming that the cost basis of the shares of preferred stock should not be reduced by reason of the receipt by her of shares of common stock of Columbia Steel Corporation as dividends on the preferred stock.

15. The Board erred in not holding and deciding that taxpayer was estopped from claiming that the cost basis of the shares of preferred stock should not be reduced by reason of the receipt by her of shares of common stock of Columbia Steel Corporation as dividends on the preferred stock.

16. The Board erred in holding and deciding that there is a deficiency [36] in taxes for 1930 of only $502.50.

17. The Board erred in not holding and deciding that there is a deficiency in taxes for 1930 of $833.48.

WHEREFORE, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit, that a transcript of the record be prepared in accordance with law and with the rules of said Court and transmitted to the clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

(Sgd) FRANK J. WIDEMAN,
Assistant Attorney General,
(Signed) ROBERT H. JACKSON,
Assistant General Counsel
for the
Bureau of Internal Revenue.

Of Counsel:
HAROLD D. THOMAS,
Special Attorney,
Bureau of Internal Revenue.

United States of America,
District of Columbia.—ss.

HAROLD D. THOMAS, being duly sworn, says that he is Special Attorney in the office of the Assistant General Counsel for the Bureau of Internal Revenue and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own

knowledge except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

(Sgd) HAROLD D. THOMAS

Sworn and subscribed to before me this 28 day of July, 1934.

(Sgd) MARCELLETTE M. TAYLOR
Notary Public.

My Commission expires March 31, 1935.

[Endorsed]: Filed Aug. 2, 1934. [37]

[Title of Court and Cause.]

NOTICE OF FILING PETITION FOR REVIEW.

To:

Corinne S. Koshland,
3800 Washington Street,
San Francisco, California.

John C. Altman, Esq.,
615 Russ Building,
San Francisco, California.

You are hereby notified that the Commissioner of Internal Revenue did, on the 2nd day of August, 1934, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decision of the Board heretofore rendered in the above-entitled

case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 3rd day of August, 1934.

(Signed) ROBERT H. JACKSON,
Assistant General Counsel
for the
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 13 day of August, 1934.

(Sgd) CORINNE S. KOSHLAND,
Respondent on Review.

(Sgd) JOHN C. ALTMAN,
Attorney for Respondent on Review.

[Endorsed]: Filed Aug. 24, 1934. [38]

[Title of Court and Cause.]

STATEMENT OF EVIDENCE.

The following is a statement of evidence in narrative form in the above-entitled cause. This cause came on for hearing before the Honorable J. Russell Leech, Member of the United States Board of Tax Appeals, on September 18, 1933. John C. Altman, Esq., appeared for the petitioner and E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, appeared for the respondent.

LOUIS SLOSS, JR.

was called as a witness by and on behalf of the petitioner and having been first duly sworn testified as follows:

Direct Examination.

From February 1923 through the year 1928 I was either assistant secretary or secretary of the Columbia Steel Corporation. I am a son-in-law of the petitioner in this action, Corinne S. Koshland. In 1924 the petitioner purchased 150 shares of preferred stock of the Columbia Steel Corporation for which she paid par, $100 a share, a total of $15,000. I was in charge of the stock sales and the stock records at that time and I was familiar in the years 1923 and 1924 with the general set-up, the stock set-up and sales of Columbia Steel Corporation.

Whereupon the witness identified the signature of John D. Fenstermacher, secretary, to the minutes of a meeting of the stockholders of the Columbia [39] Steel Corporation on January 29, 1923 and without objection said minutes were received in evidence as Petitioner's Exhibit No. 1 with privilege of substituting a photostatic copy or another copy thereof. (Photostatic copy of said exhibit attached hereto) [Set out herein at p. 59.] The witness then identified the signature of Mr. Fenstermacher to the minutes of a special meeting of the board of directors of the Columbia Steel Corporation held on January 5, 1925; and also the minutes of a special

(Testimony of Louis Sloss, Jr.)

meeting of the board of directors held on February 18, 1926. Without objection said minutes were received in evidence as Petitioner's Exhibits Nos. 2 & 3 respectively, with right to substitute photostatic copies therefor. (Photostatic copies of said exhibits attached hereto) [Set out herein at pp. 65, 69.] The witness then identified his signature, as secretary, to the minutes of a meeting of the board of directors held on January 17, 1927 and also the minutes of a meeting of the board of directors held on December 19, 1927 and without objection said minutes were received in evidence as petitioner's Exhibits Nos. 4 & 5 respectively, with right to substitute photostatic copies of said exhibits and of any further exhibits. (Photostatic copies of said exhibits attached hereto) [Set out herein at pp. 75, 77.]

The witness then identified Mr. Fenstermacher's signature to the minutes of a meeting of the board of directors held on February 19, 1923, and without objection said minutes, together with the form of certificates for common stock and preferred stock appended thereto and referred to therein was received in evidence as Petitioner's Exhibit No. 6. (Photostatic copy of said exhibit attached hereto) [Set out herein at p. 83.]

The witness on direct examination testified further as follows:

I personally handled the matter of the purchase of these 150 shares of stock in 1924 on behalf of Mrs. Koshland and I arranged for the payment of the $15,000. Mrs. Koshland paid $15,000 to the

(Testimony of Louis Sloss, Jr.)

Columbia Steel Corporation for the 150 shares of stock, $100 a share. As to the source from which Mrs. Koshland received the 750 shares of common stock of the Columbia Steel Corporation, [40] those shares were a portion of the shares allotted to Mr. W. E. Creed by the Columbia Steel Corporation for turning in certain property to the company, the properties of the old Columbia Steel Company, of the Utah Coal & Coke Co., some iron mining property in Utah, and so on. Mrs. Koshland did not have any interest in these various properties Mr. Creed turned over.

Cross Examination.

On cross examination the witness testified as follows:

The Columbia Steel Corporation was formed in the latter part of 1922. Mr. Creed turned over some properties to the corporation and got some stock for it. I know something else about the Columbia Steel Corporation and who all was interested in it. Mr. Creed was the only one who got stock in that particular way. These were some subscribers to stock of the Columbia Steel Corporation on a cash basis and there were former stockholders of the old Columbia Steel. As to whether it was a reorganization, the old Columbia Steel Company was at Pittsburg, California. When the Columbia Steel Corporation was formed it was their idea to go back to the raw materials, making pig iron and changing the pig iron to commercial iron and then proceed-

(Testimony of Louis Sloss, Jr.)

ing with the manufacture. Mr. Creed had an interest in the old Columbia Steel; he was the largest stockholder or the second largest. As to the source of these properties, they had been presented to him by the promoters and he conceived the idea of putting them together. The idea had been given to him and he had contracts covering those properties. When the new company was formed they did not attempt to sell any common stock on the open market; no common stock was sold at all. Mrs. Koshland paid $15,000 to the Columbia Steel Corporation knowing that she was going to get some common stock from Mr. Creed. This same idea was followed out with respect to other subscribers to stock. That is, they would [41] subscribe to some stock and pay over to the corporation a certain amount of money, knowing that they were going to get some preferred stock in the corporation and some common stock from Mr. Creed. The way in which these transactions were carried out was a means of raising new capital. The only common stock which was issued at that time was that which was issued in conjunction with the preferred stock. The company was authorized to issue to Mr. Creek or his nominees, I think it read that way, a certain number of shares of common stock. That was the only common stock that was issued, and upon each purchase of preferred stock Mr. Creed would nominate or name the person to whom that common stock was to go. I want to make this explanation in that regard, that there

(Testimony of Louis Sloss, Jr.)

was common issued in a like manner also to the holders of the old Columbia Steel Company stock who received preferred stock in exchange for the other stock and they received a lesser amount of common stock with each share of preferred. There was only one stock in the old Columbia Steel; that was common stock. They turned their stock in and I believe they received six shares of preferred stock of the Columbia Steel Corporation for each share of stock which they held in the old company. Immediately after the formation of the new Columbia Steel, the preferred stockholders of the company and the common stockholders were approximately the same persons. I believe there was some of the common stock that went for promotion services to one of the Utah men; generally speaking they were the same. As to whether generally speaking each preferred stockholder held so many shares of common stock, I would say there were no preferred members who did not hold any common, but they did not hold it in the same proportion, because some got five shares for each share of preferred and some two shares for each share of preferred. In my testimony as to Mrs. Koshland's purchase of preferred stock for $100 a [42] share, I am referring to what the books show; I am referring to the cash transaction. The corporation didn't have the common; that was already allocated to Mr. Creed. She paid the money in to the corporation, knowing she was going to get so many preferred

(Testimony of Louis Sloss, Jr.)

shares issued by the corporation and so many shares of common to be turned over to her by Mr. Creed.

Redirect Examination.

Upon redirect examination the witness identified the signature of Mr. Fenstermacher, as secretary, to the minutes of a meeting of the board of directors of the Columbia Steel Corporation held on January 29, 1923 and without objection the minutes were received in evidence as Petitioner's Exhibit No. 7 with leave to substitute a photostatic copy thereof. (Photostatic copy of said exhibit attached hereto) [Set out herein at p. 90.]

The witness upon redirect examination testified further as follows:

From the minutes of the meeting of the directors of January 29, 1923 I am able to state that the 750 shares of common stock which Mrs. Koshland received came out of the 547,500 common shares authorized at the meeting to be issued to Mr. Creed, the minutes also authorizing the issuance to Mr. Creed of 39,918.43 shares of preferred stock. I am able to state this because there were no other shares of common stock issued at that time. In other words, that 547,500 shares of common stock were received by Mr. Creed from the corporation in exchange for the transfer of certain stipulated tangible property.

Recross Examination.

Upon recross examination the witness testified:

Mr. Creed was a large stockholder of both the old Columbia Steel and the new Columbia Steel. There

(Testimony of Louis Sloss, Jr.)

may have been one larger stockholder. He owned about 7 or 8 per cent of the securities or stock of the new company. As a [43] substantial stockholder, Mr. Creed was interested in raising additional capital. He was the active head of the company. As regards the old Columbia Steel Company I suppose Mr. Creed was acting for himself and other of the stockholders because he would not have had all the stock available unless he had the consent of the other stockholders. The properties for which stock was issued to Mr. Creed consisted of a mill at Pittsburg, California, and a foundry also at Pittsburg, California, in which steel castings and steel reinforcement bars and so forth were made. The properties of the Utah Coal & Coke Company were located in Carbon County, Utah; the iron mining properties were in Iron County, Utah, near the town of Lund. They were extensive iron and coal properties and their peculiar quality lay in the fact they are the only coal properties so far discovered west of Colorado. No coal had been found in this part of the country from which coke could be made and you have to have a certain amount of that to make pig iron.

The properties just described were turned over by Mr. Creed. Mr. Creed had a contract on those properties with the various owners. One was with the old Columbia Steel holders to turn over their stock. Another was with Mr. Raznis, the representative of the coal people and the other was with

the people who owned the iron mine. As to whether a contract was entered into in the interest of all the old stockholders of Columbia Steel, I could not tell. Those contracts were entered into before I assumed my duties with the corporation but he was the only one named in these contracts.

Redirect Examination

On redirect examination the witness further testified:

Mrs. Koshland did not own any stock in the old Columbia Steel directly or indirectly and had no interest directly or indirectly in any of these [44] properties until she bought the 150 shares of preferred.

C. T. REDMOND

was called as a witness by and on behalf of the petitioner and having been first duly sworn testified as follows:

Direct Examination

I am the assistant secretary of the Columbia Steel Company. I have been employed by the Columbia Steel Corporation, the one we have just been referring to in the testimony of Mr. Sloss. I was first employed by the Columbia Steel Corporation in March, 1924 in the capacity of assistant auditor. I remained assistant for two or three years and then became assistant secretary. During the period from March, 1924 through the year 1928 I was in

(Testimony of C. T. Redmond.)

charge of the books of account of the Columbia Steel Corporation and they were kept under my supervision. I have here the original general ledger covering that period of time. I have the entries in the general ledger with respect to the dividends declared on the preferred stock in January, 1925. There is an entry in the general ledger in January, 1925 with respect to dividends declared on the preferred stock in the form of common stock. The entries show a charge to surplus as of January 31, 1925, and a credit to dividends payable. The charge to surplus represents a dividend in common stock on the preferred stock outstanding at the rate of $7.00 per share. The original records which I have in front of me show the number of shares of common stock with respect to which a dividend was paid on the preferred stock in January, 1925; that was 93,666.611 shares. The amount charged to surplus with respect to those shares is $655,666.28. That represents $7.00 per share on each share of common stock. The other entry was a credit to dividends paid. Further entries were made with respect to this transaction later. On January 31, 1925 an additional entry was made debiting dividends payable in the amount of $655,666.28, crediting common stock $655,417.00 and also crediting [45] acrued dividends payable of $249.28. The last two figures mentioned equal the full amount of the charge to surplus. There was a segregation of that small item of $249.28 because on the computation

(Testimony of C. T. Redmond.)

of the common stock dividend on odd shares at the rate of $7.00 there were fractional shares. These fractional shares were credited to the individual stockholders but not issued at that time. The original books of account of the Columbia Steel Corporation which I have here shows that the surplus of the company which was on hand on January 1, 1925 was $690,807.19. I will give you the same data with respect to the dividend declared on the preferred stock in the form of common stock in January, 1926. The entry as of January 31, 1926 shows a debit to surplus of $663,677.79, and a credit to dividends payable $663,677.79 an additional entry debiting dividends payable $663,677.79 and crediting common stock $663,621.00 and crediting accrued dividends payable $56.79. The explanation as to this little item of $56.79 is the same as that given by me with respect to the other small item for 1925. The records show that the number of shares issued at that time as dividend in common stock on the preferred stock was 94,811.113 shares at the rate of $7.00 per share, or a total of $663,-677.79. The original ledger shows that the surplus of the Columbia Steel Corporation on hand January 1, 1926 was $827,713.80. Turning now to the dividend declared and paid in January, 1927; a charge to surplus $690,233.10; credit dividends payable $690,233.10. The entry was made as of January 31, 1927. The further entry was made charging dividends payable of $690,233.10, and crediting common stock $689,234.00, and crediting accrued dividends